MODERN
MARKETING

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PREFACE

The presentation of one more book on marketing may expose its authors to the charge of redundancy. Their excuse is that they have found it expedient in their own teaching to develop a new approach to the subject. This volume embodies the results of that approach. It represents a point of view which may differ from those offered in other texts. The authors have found this readjustment to be desirable for the instruction of their own students. They believe that the changes, adaptations, excisions, and simplifications which have resulted in this volume clarify the subject of marketing for instructional purposes on the collegiate level, particularly for students whose only background is a general course in economic theory and their own experiences as consumers.

The basic premise of this book is a simple one: that it is more profitable for such students to examine the general theory of marketing than it is to rehearse at length the practice of marketing in the various fields of business. When a student has an understanding of the reasons underlying marketing procedure, he is prepared to apply himself to the solution of marketing problems that contain new factual material. When he knows the actual details of marketing practice in a number of industries, he may have committed to memory many facts; unless he is confronted with marketing problems involving the same facts, he may, however, be unable to think in a new situation. This book endeavors to describe the *why* of marketing procedure, not the *what* or the *how*.

The use of this volume as a text necessarily imposes upon the instructor the task of directing the reading of his students into illustrative and factual material beyond the range of the text. It also involves a willingness to induce the application of theory to practice by the consideration of problems in marketing which contain new factual material or which appear in a setting previously unconsidered.

A number of important aspects of marketing have been deliberately simplified. The experience of the writers indicates the desirability of this attitude. Those students who enroll in a one-semester course in marketing as part of a basic training in economics or in business may be confused by a mass of factual detail or by the enforced study of certain complex subjects which may profitably be deferred to an advanced course. Those students who continue their work in marketing bring to the study of complex detail and advanced problems an interest and attention that provide the momentum necessary for the proper appreciation of the more difficult and involved aspects of the subject.

The present volume, through its attention to the general theory of marketing, is designed to meet the needs of both groups of students. It provides a basic understanding of the subject for students who do not intend to pursue their work in this field. It lays the foundation for advanced study of more complex problems in marketing.

The authors wish to acknowledge the extremely helpful cooperation of their colleagues, Professor Wayne Stackhouse and Mr. Donald Blankertz, who have assisted in teaching with the text and who have freely devoted their time to the careful consideration of various chapters. The authors alone, however, accept the responsibility for all statements made in the text.

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PART I

INTRODUCTION TO MARKETING

This is a book describing modern marketing methods. It attempts to tell you how the things you buy are brought to you and how factories are supplied with raw materials and parts. It describes the work of the various types of individuals and business concerns engaged in distribution. It also tries to tell why goods are marketed as they are. It is not designed to serve as an inexhaustible source of facts about marketing. Rather it is designed to make you think about marketing and to prepare you to apply the results of your thinking to the solution of marketing problems.

At the head of each chapter you will find one or more quotations. These quotations do not represent the beliefs of the writers of this book, nor are they necessarily direct quotations from books, magazines, or speeches. They represent, however, the basis of common controversial thought. They reproduce the tenor of statements which are frequently encountered. You may agree with some of them—with others you may disagree. Think about them. Think about them before and after you read each chapter. Your opinions may change.

Part I contains two chapters. The first deals with the general problem of the relation of marketing to economic activity. The second deals with the position of consumers in the marketing process.

CHAPTER I

THE IMPORTANCE OF MARKETING

"The wholesaler and the retailer make all the profit," said the farmer, "and I make all the loss. They pay me less than half of what the consumer pays them. Their costs are too high. If I could sell direct to consumers I would make more and consumers would pay less and we'd all be better off."

What Is Marketing?—You buy a loaf of bread for 10 cts. at the corner grocery store. It is packaged, ready to be taken home, and sliced, ready to serve on the table. You pay the grocer and think no more about it. This time stop a moment and think of how that particular package of bread reached the store counter where you found it. By what manufacturing process has it been transformed from wheat growing in Dakota fields? How has the grain been transported, stored, graded, bought and sold perhaps ten times over, insured, transformed, handled by baker and retailer? What is the nature of that process which begins in a field of growing wheat and ends at the counter of a grocery store?

As a consumer of bread you are at the end of a long chain of activities beginning in a wheat field and continuing through local buying agencies, country elevators, central elevators, millers, wholesalers of flour, bakers, and ending at the corner grocery. The chain includes transportation by truck and railroad—possibly by boat over the Great Lakes. It also includes the assistance of bankers and insurance agents, of traders on the central wheat exchange, and of the many other exchange functionaries who grade and classify the wheat and supervise and protect the trading operations. Hundreds of men and dozens of agencies have assisted in transforming the wheat to flour, the flour to bread, and in bringing that bread, sliced and wrapped, to the counter of your corner grocery where you can purchase a loaf for 10 cts.

Multiply the loaf by all the other articles for sale in that grocery store. Multiply by the thousands of different types of mer-

chandise for sale in every other type of retail store. Multiply by the products which are never sold in retail stores, but which find their market in industries, the raw materials of factory production, the tools and machinery of giant industrial plants, the office equipment. These are all the world's goods which in some way or other must be assisted to move from producer to consumer. Add the services which are sold, sometimes with goods and sometimes separately, and the intangible activities of men for which you pay as you pay for merchandise. The result is the raw material of marketing. Marketing brings all these goods and services from producers to consumers.

In formal definition "marketing includes those business activities involved in the flow of goods and services from production to consumption."[1] It is the second of the two great economic processes: production and distribution.

Various Marketing Activities.—The study of marketing involves the study of all the activities included in moving goods and services from producers to consumers. Among these activities may be listed the major marketing functions[2] of selling, buying, traffic management, storage, financing, risk management, and standardization.[3] The study of marketing also includes the study of the agencies (wholesale houses, retail stores, banks,

[1] Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

[2] Every text on marketing lists the so-called "marketing functions." Seldom do the authors agree on what these functions are. The seven mentioned above are included in practically every text.

[3] "Selling is the personal or impersonal process of assisting and/or persuading a prospective customer to buy a commodity or service or to act upon an idea."

"Traffic management is the direction and control of all major physical movements of goods throughout the marketing process."

"Storage is the marketing function which involves holding and preserving goods between the time of their production and their use."

"Financing is the provision and management of the money and credit necessary to get goods from the producer into the hands of the consumer."

"Risk management is the assumption or avoidance of the danger of losing pecuniary value of goods during the process of marketing them."

"Standardization involves (1) the determination of basic limits or grades, and (2) the establishment of model processes and methods of producing, handling, and selling goods and services."

Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

railroads, insurance companies, etc.) which perform these marketing activities, of the cost of performing the functions, and of the changes which have been and are taking place in marketing. The study of marketing surveys the entire business world beginning at the factory door and ending at the retail counter when you exchange your money for merchandise on sale. It is the study of one-half of economic life.

Changing Nature of Marketing.—It is not the study of something past or dead. Within the past 5 years have occurred changes in marketing which have revolutionized hundreds of businesses. Within the past 25 years it has been necessary to revise completely our knowledge of the marketing process. Within the past 100 years all that we know today as modern marketing has developed, growing in what appears to be one tremendous bound from the simple rudimentary buying and selling processes which were found in the world of ancient Greece, in the Middle Ages, and even as late as 1825. Changes are occurring today. Before 1930 the word "supermarket" was unknown. Before 1936 few would have doubted the assured future expansion of the chain-store systems. Prices are no longer determined solely by the equation of supply and demand. The cooperative movement is encroaching on what used to be the exclusive domain of individual initiative. Governmental regulation is influencing the activities of marketing.

Through the ages man has resisted the coming of new ideas. In few fields has there been a greater exception to this general statement than in the field of marketing. Today the study of marketing is the study of dynamic economics. A reproduction of the marketing process must be made with a motion-picture camera. The established marketing patterns are in constant flux. A manufacturer of shoes decides to stop selling to independent retail shoe stores and opens his own retail stores. A great grocery chain-store system begins to manufacture its own bread. Independent druggists organize a voluntary chain and support their own wholesale house in order to place large orders with manufacturers and so meet the competition of chain-store systems. A majority of the orange growers of a state pool their crops and market them under one brand name. New products by the thousands are offered to consumers every year; some are never heard of again; others go on, and millions of dollars are

spent for advertising their virtues. Prices shoot violently up and as suddenly subside. And all the time you can visualize a great flow of goods and services proceeding from producers to consumers. Not always does this flow proceed in the same way. There are many changes. Sometimes the attempts to find new channels are successful. Sometimes they end in failure.

Marketing is not so much an exact science as a fine art. This book will attempt to describe the theory and the practice of marketing as it is today. It will try to tell what has been done and what is being done and why things have been done in this way. There is no guarantee, however, that marketing practice will continue in the future without change. The lifeblood of marketing has always been change. Out of repeated experiments and the patient accumulation and interpretation of experience will come new forms of marketing practice. Study of past[1] and present practice provides the necessary background for understanding the possibilities of future change.[2]

What Is a Market?—The word "market" will be used frequently in speaking of the marketing process. It may be used to mean three different things.[3] It may mean, for example, (1) all the buyers of a product, as one might speak of the market for refrigerators, meaning all the potential buyers of electric refrigerators living in the United States or in any part of this country. Sometimes (2) the word may be used to mean all the people living in a given area, as, for example, "the American market," a phrase which refers to the total population of the country and its purchasing power as representing a mass of consumers. Frequently (3) the word "market" is used to describe an organized trading place for one or more commodities. In this sense you will see the phrase used to describe the Chicago Board of Trade as a grain market, or the New York Stock Exchange as a stock market.

[1] That the study of marketing is not at all new is shown in J. M. Cassels, The Significance of Early Economic Thought on Marketing, in *The American Marketing Journal*, October. 1936, p. 129.

[2] This subject is reviewed at length in George Burton Hotchkiss, "Milestones of Marketing," The Macmillan Company, 1938.

[3] Because the word is used in the various ways described in the text, it is difficult to offer an adequate definition of "a market" within the scope of a single brief sentence.

It is not necessary that the word denote a special place. It may refer to a place, but it may also be used as in the following phrase to refer primarily to a group of buyers not bound together by the limits of a geographic area: "the quality market"—meaning the general group of people in the upper income classes throughout the country considered as potential consumers.

In general, the idea of a group of *buyers*, rather than the idea of a limited *area*, dominates the conception of a market. The various uses of this common word may be confusing, however, unless the three major interpretations are kept clearly distinct and some care is taken to make the meaning of the word clear in its particular setting.

Because relatively few products are sold to everyone, and because most products are sold to particular groups of people, business concerns engaged in marketing must think in terms of markets. Some products, such as air-conditioning equipment, may sell well only in certain parts of the country. Other products, because of their relatively high prices, may be bought in quantity only by the upper income classes. In either of these cases, manufacturers must think of the markets for their products; they must attempt to measure the size of the markets, the number of potential consumers in the markets, their buying habits, and many other factors which may vitally influence the sale of merchandise. A number of products, such as wheat, rubber, and corn, are freely bought and sold on organized commodity exchanges, and businessmen dealing with these products must have continuous information on the state of the market for their particular products.

The Object of Marketing.—The end of all marketing activities is the satisfaction of human wants. The earning of profits is the incentive which induces businessmen to attempt to satisfy wants. Private business is organized to make a profit. No one can stay in business very long unless his income is at least equal to his outgo. Very few men will continue in business year after year unless, in addition to meeting all the costs of doing business, their income is sufficient to provide a return on the money invested in the business roughly equal to or exceeding what might be earned by investing the same amount of money in some other way. A business may lose money for a time and continue to

operate. Unless profits eventually appear, that business must cease to exist.

This principle guides the operations of every phase of marketing. The performance of a service which assists the marketing process, the handling of merchandise, the incurring of risk, the direction of the flow of merchandise, the provision of storage space, the maintenance of a retail store—all these marketing activities are carried on because the men engaged in each one of them have invested money and are providing their services, their time, their efforts, and their brains in the hope of earning a profit.

The result of this private profit seeking is the profusion of merchandise which you can buy at your corner grocery store: oranges from California, potatoes from Maine, bread from Dakota by way of Chicago, canned goods from factories all the way from California to Massachusetts, apples from Washington, grapefruit from Florida. The result is the display of dresses you find in the women's departments of a large department store. The result is the thousands of items displayed on the counters of the variety chain store.

It would be foolish to think that through the operation of private profit seeking, the marketing process has reached a state of perfect efficiency. The men engaged in marketing would be the first to point out the inefficiencies, the wastes, the surpluses, and the unfilled needs which are present throughout the marketing process. But in the course of time, wherever something is being done which could be done more cheaply, private gain will provide the driving force for inventive talent to find the cheaper way. The constant urge to earn a profit by doing something more cheaply, the constant offering of new and improved ways of performing the same job, have contributed to the changes which have been occurring in the marketing processes. To the same urge we owe the multiplying of the variety of goods offered for sale, the improvement in quality, the steady downtrend in prices.

In the longer view, the object of marketing is more than the securing of a profit. It is the successful distribution of the products of our land, our mineral wealth, and our factories. It is the raising of the standard of living by increasing the flow of

goods and services to consumers. It is the ultimate satisfaction of human wants.

Varying Attitudes toward Marketing.—The producer, the middleman, and the consumer regard the marketing process from different points of view. This contrast in outlook is in large part responsible for many apparent inconsistencies in the marketing process and may underlie the charges of inefficiency which have been directed at marketing.

The producer is concerned primarily with selling the products of his farm or his mine or his factory. To some extent he may control what he produces so as to offer for sale only what he thinks his customers will want to buy. In many instances, however, as in the case of the farmer, his ability to control quantity and quality of products and his flexibility in changing the nature of his product in accordance with shifts in consumer demand or in prices may be very limited. The producer must think in terms of over-all profit which covers both production and distribution. He may, for example, operate a factory and find that the cost of producing each unit decreases as the number of units produced increases. The nearer capacity he operates his plant, the lower are the unit costs of production. But increasing the volume of production means that more units must be sold. This may complicate his marketing task. He has to seek wider markets; he must try to sell his products to people who have never before purchased them or induce those who are already customers to increase their use. He may be forced, therefore, to increase the number of salesmen he employs and to spend larger sums for advertising and other types of sales promotion. He may, in some cases, find that his marketing costs per unit increase. It may still be profitable to extend the volume of his production, provided that the decrease per unit in production costs exceeds the increase per unit in marketing costs. Under such conditions he will make larger profits, yet his product will be sold to consumers at a lower price.[1] Successful marketing is always moving toward this goal.

[1] "A shoemaker may be able to make a pair of shoes for $5 upon receiving an order from a single customer. The costs of distribution are very small. A large shoe factory, on the other hand, can probably manufacture similar shoes by the millions for $2 a pair but it must spend $2 a pair for distribution. As a result the consumer gets his shoes for $4 a pair instead of $5. The

The various types of middlemen—wholesalers, jobbers, brokers, and retailers—are primarily concerned with the service of supply. They have little direct control over what is produced and possibly less control than the producers over what is consumed. Their risks are bound up in the two factors of inventories and prices. Do they have the right merchandise on hand? Will prices fall and will they be forced to sell at a loss? Competition between middlemen may lead to price cutting or to the offering of more services to customers. Within the relatively narrow margin limited by the prices at which they buy and the prices at which they sell, they must endeavor to protect themselves against the uncertainties of inventory losses and adverse price movements, to perform their services as completely and efficiently as possible, and still retain enough over expenses to return a profit on their investment.

The consumer looks at marketing solely from the point of view of goods and prices. Can he buy what he wants to buy at the price he wants to pay? The losses and mistakes which have occurred in the marketing process before goods reach the counters of retail stores are no concern of his except as they affect the quantity, the quality, and the price of the goods and services he wishes to purchase. He is not only the end, but the most important part of marketing. All goods are produced to suit his needs and his desires, and they must be produced long before he expresses his needs and desires in the form of purchases. If he changes his mind and decides not to buy this year what he bought last, the manufacturers and the middlemen who have not anticipated changes must sell at a loss merchandise which is no longer in the forefront of demand. He is still not concerned, unless those mistakes and the resulting losses bring about a rise in costs of operation and make prices higher. It is important in studying marketing to realize that the same person may occupy more than one position. He may be both producer and consumer. The farmer is a producer of corn. He is a consumer of corn syrup. As a producer he would like to see prices rise; as a consumer he would like to see prices fall. All

test is not whether more or less costs are assigned to certain economic functions like production or distribution, but whether in the end the consumer gets a better or cheaper product."—"Distribution Services and Costs," Chamber of Commerce of the United States, 1939, p. 17.

people are consumers, and many also occupy positions in one of the other two classes as a result of the ways in which they earn a living. The student of marketing should see beyond his personal position and should appraise each marketing problem from a neutral position which sees and understands the several and occasionally conflicting points of view.

Social Importance of Marketing.—The points of view of producer, middleman, and consumer are different, but each is individualistic, each is concerned with a private profit. Marketing has even greater significance for society as a whole than for any of the individual beneficiaries of the marketing process.

The nation's income is really composed, not of money, but of the goods and services which money can buy. If prices fall and a man can buy more goods and services for the same amount of money, his income has been increased. Any increase in the efficiency of the marketing process which results in lower costs of distribution and lower prices to consumers really brings about an increase in the national income. Improvements in marketing are, therefore, of great social importance. A reduction in the cost of marketing is a direct benefit to society. The man who makes such a contribution renders a service as important as that of the inventor of a laborsaving device or a new manufacturing process. Not always has there been recognition of the importance of such contributions to human welfare rendered by improvements in the technique of marketing.

The marketing process has been improved, not only to bring goods to consumers more cheaply, but also to improve their quality, to identify merchandise by brand names, and greatly to increase the variety of merchandise offered for sale. A wealth of merchandise can be purchased at retail stores which was not available to our grandfathers.[1]

But this does not complete the pattern of the social importance of marketing. More than one-third of all persons gainfully employed in this country are engaged in the field of marketing. Even omitting those persons engaged in professional, clerical, and domestic service in connection with marketing, more than one-fourth of those gainfully employed work at some of the many aspects of marketing. Approximately one-fourth of the money

[1] Improved transportation and storage have played an important part in making available this wider variety of merchandise.

which buys the goods and services which make up our national income is earned by marketing work.

Growing Interest in Marketing.—Until about 1920 the major interest of businessmen was centered on problems of production. The development of mass-production methods, refinements of machine technique, factory organization, application of labor to machinery, personnel management, compensation methods, and incentive payment systems occupied the center of the business stage. Cost-accounting methods were developed. Scientific factory management was studied and applied. By 1925 the common remark was, "We have solved our production problems; we have yet to solve the problems of distribution."[1]

In recent years the direction of study has turned to the problems of marketing. Marketing inefficiencies have been exposed and duplication and waste have been studied by both private business and governmental agencies. We have not yet solved our problems of distribution; but it may safely be said that we are moving toward a solution of many of the major problems which have been hampering the efficient performance of the marketing functions for many years.

Business now knows the wastes of duplication and multiplication of sizes, colors, styles, and materials. It has some understanding of the use of research techniques in determining the location, size, and potential volume of consumer markets. Studies are being carried on to develop suitable cost-accounting techniques for use in marketing. The result of this type of study should be the removal of marketing from guesswork to knowledge. More and more, businessmen are supervising operations with a knowledge of the number and location of possible buyers for their products, with a knowledge of how much they want to spend and what they want to buy, with a knowledge of the brands they prefer and the retail outlets in which they customarily purchase. They are beginning to measure the cost of selling their products through the various channels of distribution; they are measuring the relative efficiency of different types of advertising and sales promotion. They are relating return to cost in every phase of marketing. The result should be not only increased profits for those firms which can guide their operations

[1] "Wise consumption is a far more difficult art than wise production."—John Ruskin.

by more exact knowledge, but better products for consumers, products more easily accessible, products more perfectly adapted to the needs of consumers.

Marketing research, distinguished for its rarity before 1925, is now being carried forward by private firms, by trade associations, by financial institutions, by governmental agencies, and by private and state universities. A wealth of knowledge relating to every phase of marketing is being accumulated.[1] Applied by business to the problems of distribution, it is yielding an increased measure of profits.

The Role of Government.—We are living in an age of political upheaval. The relation of government to private industry is undergoing a major change of which it is possible at this time to chart only the general direction. Throughout the nineteenth century when the processes of marketing were slowly developing into the structure we have today, the part of government was essentially that of the umpire who set the rules of conduct and safeguarded business procedure through the protection of the right of free contract. The general underlying spirit was the protection of competition. It was this spirit which, regardless of the result, supported the creation of the Interstate Commerce Commission, the Federal Trade Commission, and similar bodies of authority. The general theory of the right of free price movements in free competition was unchallenged.

More recently the part of government has been changing, and it is possible to see, underlying that change, a shift in the theory of the part government should play. There appears to be some shift toward granting powers to government bodies to interfere with free price movements and free contracts. The state fair-trade laws, the federal Miller-Tydings Act, the Robinson-Patman Act, the state unfair-practices acts, and the chain-store tax legislation are all based upon a modification of the nineteenth century theory of the relation of government to business. They represent for government a departure from its traditional role as the guarantor of contracts.

Profound changes in marketing procedure have occurred as a result of these laws, and there may be more to come. As a

[1] "I Owe So Much to Men I've Never Met" is the headline in a Monsanto Chemical Company advertisement which pays tribute to all those engaged in this type of research.

result of the Robinson-Patman Act many manufacturers who formerly sold to both large and small customers are limiting their business to one of the two groups. As a result of the state fair-trade acts prices of many types of merchandise have been fixed and the development of private brands has been given a tremendous impetus. As a result of the unfair-practices acts a floor has been put under prices of many types of merchandise as a limit to price cutting. As a result of the chain-store taxes in many states supermarkets have developed, chains in the grocery and drug field have closed a number of their stores and are even considering leasing or selling their stores to their present employees and serving solely as wholesalers.

Marketing procedure today as never before is in process of change. Much of this change is the direct result of the new part that government is playing in the economic world.

Current Criticism of Marketing.—Many charges have been directed at modern marketing practice. Most of them are constantly discussed in the daily press and in magazines. It is said that marketing is too expensive. It is said that money spent for advertising is largely wasted, particularly when manufacturers of well-known brands buy pages of space in national magazines for promotion which is largely competitive. It is said that the quality of many types of merchandise is far from satisfactory. It is said that the profits of wholesalers and retailers are excessive and out of line with the services they render. Small independent retailers have accused chain-store organizations of price policies designed to eliminate the independent store from its competitive position. Wholesalers have accused manufacturers of attempting to sell direct to retailers. Independent retailers have complained of the price practice of manufacturers who granted discounts to large retail buyers.

One result of this wave of criticism of marketing practice has been the increased attention given to improvements and new developments in marketing procedure, designed to eliminate many of the faults which brought about the criticism. Another result has been the legislation imposed upon marketing. Obviously there are conditions in marketing which justify certain of the attacks made upon it. Just as obviously many of the attacks have been hastily conceived and are the result of illogical partisan thinking. The answers must come from those now engaged

in the thousand marketing activities and from those who will be engaged in them in the future.

The Cost of Marketing.—No one knows exactly what the costs of marketing are.[1] Even in individual business concerns, the application of cost accounting to selling expense has been so recent that only a very limited knowledge is available concerning the costs of selling various products or of selling to different customers. Reliable information about the costs of marketing is limited to a knowledge of the approximate costs of marketing certain individual products. We know, within a small margin of error, the cost of assembling California oranges, bringing them to market, and selling them. We do not know the share of the retail grocer's cost of operation which should be charged to the oranges which make up a small part of his stock.

The farmer knows enough about the cost of marketing to realize that the price he receives for his produce is a very small part of the price the consumer pays for the same produce in the retail store. When he reasons from wholesale to retail price in this manner, he often does not stop to think of the many activities and the many agencies which are necessary to bring his products to market, or of the risks involved.[2] Farmers have often attempted to short-circuit the middlemen by selling direct

[1] "The cost of distributing America's manufactured goods for the year 1935 . . . reached the imposing total of between 15 and 15½ billion dollars, according to my estimates."—NATHANAEL H. ENGLE, Distribution Cost Analysis by Commodities, *Boston Conference on Distribution*, 1937, p. 46.

[2] "Confusion about distribution processes and distribution costs often arises because of lack of knowledge, and because of failure to define concisely what is meant by various widely used terms. For instance, unit prices for raw materials or finished products sold in wholesale quantities are frequently compared with prices for articles sold to consumers at retail prices, and the spread ascribed to 'distribution costs.' The price of a sirloin steak served in a restaurant in New York City is often compared with the price of beef on the hoof at the stockyard; the price of razor blades is compared with the price of ingot steel; while the price of a cotton shirt is compared with the price received by a Southern cotton grower when he sells a bale of cotton. Too often such comparisons disregard entirely complex and costly fabricating processes which completely alter materials into articles suitable for the specialized needs of consumers, and also disregard extensive and costly services rendered in connection with processes of transportation and distribution."—"Distribution Services and Costs," p. 8.

to consumers, yet in only a few instances has the attempt been successful. In the majority of cases those who attempted to sell direct found that they could not perform the services of the middlemen as cheaply as the specialists, and they found their expenses outrunning their income.

When you spend $1 for a product in a store, as much as 85 cts. out of that $1 may go to pay for the costs of marketing it, and as little as 15 cts. may suffice for the manufacturing costs.[1] That fact in itself does not prove that marketing costs are too high. In the last analysis, the cost of marketing that product is too high only if there is a cheaper way available.

The efficiency of marketing must be measured on a relative, not an absolute, scale. That is why the tendency for marketing costs to rise during the past 25 years means nothing in itself. The price of almost every type of merchandise sold today is less than was the price of the same article 25 years ago. For equal quality, prices have tended to decline. This has occurred despite a rise in marketing costs. How has this been possible?

Rising Marketing Costs.—Think back to the statement made earlier in this chapter about the importance of considering production and distribution costs *together, not separately*. Seeking lower costs, industry has tended toward giantism and the economies of mass production. In many cases that very movement has been instrumental in causing marketing costs to rise. Larger factories with increased output made it necessary to seek larger markets, to sell over larger areas, in distant parts of the country, in foreign countries, to increase the sales force, to spend more for sales promotion, to work with retailers to increase sales, to train retailers in the art of selling. At the same time, consumers were demanding a larger variety of merchandise, more choice of styles, colors, sizes, materials. They expected more service from their retail stores. Inventories became larger and the risk of loss on style changes increased. The costs of providing retail services mounted. Yet as long as the decrease in production costs exceeded the increase in marketing costs, consumers gained. They possessed better merchandise. They secured services from retail stores. They had a larger selection of merchandise from which to choose. *And they paid lower prices.*

[1] "It actually costs Continental more to deliver a loaf of bread, from bakery to grocery store, than it costs to manufacture it."—*Fortune*, July, 1938, p. 69.

Many marketing costs *are* too high. But the selection of just which costs are high and the location of waste, duplication, and excessive selling effort need very careful analysis. The analysis should be made. Society will benefit from an increased flow of goods and services at lower prices, and those who discover the wastes and improve the marketing process will receive high profits. As far as cost analysis and the development of efficient technique are concerned, many phases of marketing today lie on the frontiers of American business, with all the risks and all the opportunities which a frontier presents.

Channels of Distribution.[1]—In marketing his product, a producer may choose between a number of channels of distribution.[2] He may sell to a wholesaler who in turn will sell to a retailer who sells to the final consumer. This is probably the oldest conventional marketing pattern.[3] But there are many producers who sell direct to retail stores, thus eliminating the wholesaler. There are even producers, such as the Fuller Brush Company and the Real Silk Hosiery Mills, Inc., who sell direct to consumers, eliminating both wholesaler and retailer.

More complex channels of distribution exist. Wheat is usually sold by the farmer to a local elevator company which in turn sells to a central elevator company which sells to a mill. Title to a product may change as many as twenty times between producer and consumer. Whether the method of distributing a product be simple or complex, it is important to realize that there need be no direct relation between the number of times a product changes ownership and the cost of marketing that product. A simple distribution process may be more costly than a complex one. A producer may choose to sell part of his product to wholesalers and part direct to retailers. A producer may sell through different channels in the same territory. His choice of distribution channels will be determined by consideration of such factors as the relative cost of different channels of distribution, the characteristics of the product (risk of style change, spoilage, etc.), trade custom, problems of carrying inventories in local territories, and competitive practice. He will endeavor

[1] The channel of distribution of a product may be thought of as the middlemen through whom the title passes as the goods move from producer to consumer.

[2] Sometimes spoken of as "trade channels."

[3] Therefore it is often called the "orthodox channel of distribution."

to select distribution channels which will give consumers the merchandise they want to buy in the way they want to buy it and at the lowest possible cost to himself.

Channels of distribution are constantly changing. Within one trade no two manufacturers may distribute their products in exactly the same way. The selection of channels of distribution may vary widely between industries. Experiments are constantly being made. A manufacturer may find that one method of selling is adapted to his product during its introductory stage, and another method is more adequate after it has been soundly launched upon the market. This is sound marketing practice because only through such experimentation can new and more efficient methods of marketing be developed.

Concentration and Dispersion.—A dual process of concentration and dispersion characterizes the marketing of many types of products. Products are rarely moved from points of production or growth direct to retail stores and consumers. Farm products are assembled from many small producers in a general concentrating movement and flow into major concentration pools or central markets. From these central concentration points they are dispersed to subsidiary markets and finally reach retail stores. Some types of manufactured goods follow the same pattern of concentration and dispersion. Even when manufactured goods flow directly from factory to retailer in a dispersion movement, there has been, in many instances, a previous concentration and dispersion movement of raw materials prior to factory production.

There are a number of reasons for the presence throughout marketing of a general tendency toward concentration and dispersion. Transportation rates, handling difficulties, problems of standardization and grading, problems incident to the equalization of supply and demand, problems of financing and storage, all contribute to the desirability of handling merchandise in bulk.

Today more than ever before, the entire range of marketing activity is being subjected to renewed study and experimentation; new combinations are being evolved and more accurate methods of analysis are being applied to the problems of distribution. Today more than ever before, modern marketing presents a panorama of shifting risk and opportunity, a challenge to student and businessman.

CHAPTER II

THE CONSUMER

"Consumers?" said the country storekeeper. "I don't fuss with them. They buy what I sell." . . . "Consumers?" said the chain-store operator. "We take a lot of trouble with them. We try to sell what they want to buy."

How Important Is a Consumer?[1]—Walk into a shoe store and let the clerk measure your feet. Let him bring out shoes for you to inspect and try on. Examine the various styles, materials, and colors which are offered to you. Choose between the different qualities and prices. Do not hurry; there is no need to hurry. Whatever your want may be, if that store can satisfy it, every attempt will be made to do so. If you find what you want, you may buy a pair of shoes. If you dislike what the store has to offer, you may decide against buying and walk out of the store. You may do the same thing in half a dozen shoe stores. You are under no compulsion to buy. If you search long enough you are almost certain to find what you want. You are the master of the buying process. The stores are catering to *your* wants; they are trying to sell what *you* want to buy. If they do not keep in stock shoes which you and other consumers want to buy, they will be forced to take large price cuts in order to dispose of their merchandise. They will be unable to earn profits unless they have good success in forecasting what consumers will want to purchase and in having that merchandise in stock when consumers want to buy it.[2]

[1] The consumer is one who buys for his own use. The consumer is defined at length in C. S. Wyand, "The Economics of Consumption," Chap. IV, The Macmillan Company, 1937. Another interesting description of the consumer is found in the *Consumers' Guide*, September, 1938. The word "consumer" is used occasionally to refer to a business purchaser, as a factory buying raw materials. Usually, however, and in this chapter, the word is used to refer to the ultimate consumer.

[2] "It is not merely a fine trick to be able to anticipate public taste; the development of ability to do this is the only way to stay in business."—PAUL T. CHERINGTON, A Revolution of Business Motives and Their Rela-

As a consumer you exercise the same freedom of choice in the selection of all the merchandise you purchase. That freedom of choice extends over the selection of color, style, material, price, quality, package, time of purchase, type of store in which the purchase is made, and the number and variety of services which are offered with the purchase. You may buy when you please and as you please. You may purchase today or postpone the purchase indefinitely. You may pay cash, open a charge account, or pay for your purchase in installments. You completely dominate the selling process. Increasingly in recent years retailers have grown to recognize this point. They have sought to adapt their merchandise and their selling practices to the desires of the general body of consumers.

Retailers' Services to Consumers.—In making this adaptation retailers have offered new services to their customers. Department stores have offered credit, delivery, personal shoppers, installment purchase terms, parcel checking, and a number of other services. Groceries and drugstores have offered credit and delivery service. Many types of stores have moved into more convenient locations. Stores have shown prices prominently. Retailers have directed their attention toward building more interesting and attractive displays of merchandise and have attempted to increase consumer knowledge of merchandise by providing additional information. Retailers have offered larger stocks of merchandise and a wider range of styles, prices, and materials; they have attempted to record customer desires, even when the merchandise was not in the store, and then to secure the merchandise as soon as possible. Often this analysis has led to redesigning of merchandise in order to adapt it more closely to customer desires.[1]

The success attained in these measures has been an important influence upon the profits earned by the stores. Not all retailers have been led by their analyses of consumer desires to supply the same services or the same merchandise. Consumers' desires differ. A store may find its greatest profit to lie in serving the needs of one particular group of consumers. Some customers

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tionship to Selling and Advertising, *The American Marketing Journal*, January, 1935, p. 29.

[1] Nash, Ben, Product Development, *The Journal of Marketing*, January, 1937, p. 254.

may want elaborate services with the merchandise and may be willing to pay for them. Other customers may want to purchase merchandise with a minimum of service and expect lower prices. Some customers may want to purchase only the newest styles and the best quality of materials and expect to pay high prices for them. Others may have their primary interest in price and be willing to sacrifice newness of style or the best quality in the interests of economy of purchase.

Other Middlemen's Services to Consumers.—Retailers are not alone in thinking first of consumer buying habits; wholesalers, manufacturers, and producers of every kind must plan their marketing programs in the same way. Wholesalers must think in terms of their retail customers and adapt their selling practices as far as they can to the desires of retailers. Manufacturers and other producers must think in terms of the buying habits of wholesalers and retailers and, above all, of the ultimate consumers of their merchandise. A manufacturer who is preparing to market a product begins his thinking with an analysis of the buying habits of consumers. What do they expect from this type of product? What do they want it to do for them? About how much do they want to pay? On what terms do they want to buy? In what type of store do they want to purchase this type of product? In what season of the year do they customarily purchase it? What services do they expect in connection with the purchase? Unless a manufacturer plans his marketing program in this way, unless his thinking begins with the tastes of the final consumer of his product, his chances of achieving success with it are very limited.

Why Industry Must Study the Consumer.—The recognition of the importance of the ultimate consumer in all marketing programs is of comparatively recent growth. When the marketing process was simple and when goods were made to order, the manufacturer did not have to accumulate stocks in advance of sales. He had no concern, therefore, with changes in consumer demand which might affect his product. He simply produced what his customers had already ordered. He had a small factory and frequently used his own home for carrying on his manufacturing operations. In many cases he knew his customers personally. He produced merchandise to the customer's measure and only in the styles which the customer wanted. No inventory

of finished products was carried in advance of sale and the inventory of raw materials was small. He had no need to anticipate the desires of unknown customers living at a great distance.

Modern large-scale industry faces a different problem. Goods are produced in advance of their purchase. Large inventories are accumulated. The manufacturer is separated from the final consumers, often by thousands of miles, and he deals with the ultimate consumers of his products indirectly through hundreds of wholesalers and retailers. These wholesalers and retailers also accumulate inventories. With this very limited contact between manufacturer and consumers the problem of marketing what people want to buy becomes very difficult.

Consumer Research.—Large manufacturers recognize this difficulty and have instituted programs of consumer research[1] designed to find out what consumers want to buy, how they want to buy it, when they want to buy it, and all the other information which is necessary to the formation of a successful marketing program.[2]

"The sole end and purpose of production is consumption."[3] The production process really begins with the consumer, for the manufacturer first studies the consumer, tries to determine what it is she desires, what will satisfy her wants. Having determined this, he then begins to manufacture this product.[4] At one time the manufacturer produced a product, then tried to make the consumer buy it. Some manufacturers still try to force products on consumers. The successful manufacturers know that it is much easier to give the consumer what she wants. The average manufacturer by no means has made the most

[1] The manager of sales promotion for Armour & Co., R. B. Alspaugh, discusses the use of consumer research in Present Status and Future Outlook of Consumer Research in Commercial Firms, *The American Marketing Journal*, April, 1935, p. 80.

The chief statistician in the commercial research department of Swift & Co., D. R. G. Cowan, discusses the same subject in Product Testing and Its Value to Business, *The Journal of Business*, October, 1938, p. 349.

[2] The consumer research program of the General Motors Corporation is probably the best known of these undertakings. This company spends almost $500,000 annually for consumer research.

[3] Smith, Adam, "The Wealth of Nations," Chap. VIII.

[4] A different opinion is expressed by Elizabeth Hoyt in "Consumption in Our Society," pp. 88–91, McGraw-Hill Book Company, Inc., New York, 1938.

effective use of consumer research. It has been estimated that $4,500,000 is being spent in customer research. This is still a very small sum when we compare it with an estimated annual expenditure for engineering research of $300,000,000.

Research programs of this type do not, of course, eliminate all risks. These programs do, however, provide valuable aid in developing merchandise which the great mass of consumers want to purchase and in offering that merchandise when they want to purchase it, where they want to purchase it, at the price they want to pay, and with the services which they expect to receive with the merchandise. Research programs may have a profound influence upon the choice of the channels of distribution and may, from time to time, cause changes in the selection of those channels. Such programs may demonstrate to a manufacturer the desirability of selling the same merchandise in the same territory through several channels of distribution simultaneously.

Retailers have followed a similar procedure. The successful retail storekeeper regularly devotes part of his time to analyzing the demands of his customers so that he may carry in stock the merchandise which they want to purchase. Any failure on his part correctly to anticipate consumer demand may result in large markdowns and serious losses. This is particularly true in the case of style merchandise, where one season's products may be out of style within a few months, and where the attempt to sell the style of a previous season results almost inevitably in failure.

The Consumer Market.—The consumer market in the United States is made up of 131 million people. The term "consumer market" is misleading, however. It is not one market, it is really thousands of markets. Consumers do not all have the same desires. They differ radically from one another. Their buying habits and the types of merchandise which they wish to purchase may differ. Variations in buying habits may be caused by differences in sex, age, income, place of residence, size of family, occupation of the wage earner in the family, racial background, and many other factors. Buying habits will vary depending upon the state of general business conditions. For all these reasons, therefore, it is extremely important for any producer to know as accurately as he can in advance exactly

what groups of people are potential purchasers of his product and to analyze their buying habits with the greatest care.

This is even more difficult than it seems. It would be hard enough to analyze the consumer market in this fashion if the consumer market were static. It is, of course, dynamic. Changes are constantly occurring in each of the factors which influence the buying habits of consumers. During the past 25 years there has been a tremendous growth in the population of this country. The size of the average family is smaller than it was 25 years ago. There has been a general trend of population to move toward the large cities and away from the rural areas. The combination of smaller families and residence in large cities has fostered a trend toward living in smaller houses and apartments. And, more important, many types of merchandise are purchased in large cities which are not purchased in rural areas.

The birth rate has been declining, which means that a larger proportion of the population is middle aged or elderly, and a smaller proportion of the population is made up of young children. This movement, it has been estimated, will be accentuated in the future. Occupations have changed in the past 25 years. There has been a substantial increase in the number of those occupied in clerical work, in professional service, in public service, and in trade, and a decrease in the number occupied in agriculture.

How Changes in the Consumer Market Affect Marketing.— Every one of these changes influences the demand for goods and services. The growth in population means larger markets and more consumers. The decrease in the size of the average family means that each member of the family will have a larger share of the family income spent to satisfy his needs. The trend toward living in large cities causes a shift in the centers of consumer groups and an increase in the demand for the types of merchandise purchased by urban residents. The declining birth rate may, over the period of several generations, prevent the continuous growth of the American market and in time may bring about a reduction in the sale of merchandise used by children and merchandise sold to institutions, such as schools, which cater to children. The changes in occupations may bring about changes in the location of groups of consumers, changes in family income, and changes in the types, quality, and quantity

of merchandise desired. It may also influence the demand for many types of services, for recreation facilities, and for travel.

The distribution of families in the various income groups directly affects buying habits. Families with small incomes spend the greater part of their incomes for food, shelter, and clothing. They have little surplus for the great variety of other expenditures which are made by families with large incomes. Most of the families in the United States have incomes under $4,000 a year. A manufacturer who is preparing to bring a new product on the market must think very carefully about the potential customers for that product and how their buying habits and purchasing power are influenced by their annual incomes. He may find it desirable to start with a high price and reduce it. He may find it desirable, on the other hand, to initiate mass production of merchandise of somewhat poorer quality at lower prices. In some instances he may find it desirable to modify the product or to make installment-purchase terms available to consumers. The distribution of families in the several income groups may affect a manufacturer's advertising and sales promotion plans. It may influence the publications which consumers read and the advertising appeals which are interesting to them. The manufacturer who wishes to sell products to consumers in the various income groups must direct his attention to these questions in evolving his marketing program.

How a Depression Affects Marketing.—Buying habits change markedly in periods of prosperity and depression. Our national income in 1929 was estimated to be 80 billion dollars. This declined to 44 billion dollars in 1933 and rose to about 70 billion dollars in 1937. Major changes in national income have, of course, a profound influence on purchasing habits. When people earn less, they spend less, but they also curtail their buying first of luxuries and only second of necessities. In the heart of that depression the sale of such articles as houses, automobiles, and other durable merchandise fell off very sharply. The sale of food and clothing diminished much less. People postponed buying that merchandise which they could do without and reserved their smaller incomes for the purchase of merchandise which they needed in order to live.

Manufacturers found their sales programs affected by the prices which they could secure for their products and by the inventories which they were forced to carry. In many cases the introduction of new products had to be postponed, while, on the other hand, some companies developed the policy of offering new products during the depths of the depression with the hope of securing increased sales. Companies which postponed the introduction of new products were motivated by the fear of losing money at a time of stagnant demand. Those which developed the policy of offering new products hoped to utilize idle plant capacity and half-employed salesmen by stimulating consumer demand for items previously unknown.

Dispersion of Consumers.—The consumers of this country are not spread evenly over its entire surface. In 1933 more than 47 per cent of all retail sales and more than 54 per cent of the sales of services and amusements were made in the eight geographically adjacent states of New York, Pennsylvania, Illinois, Ohio, New Jersey, Michigan, Wisconsin, and Indiana. Not all producers, however, are similarly concentrated. Many products which find their best markets in the densely populated Eastern states are produced several thousand miles away. The marketing process is thus made more complex, not only by the characteristics of the consumer market, but also by its location at a distance from producing centers. This necessitates the use of elaborate transportation and financing facilities as well as the passage of merchandise through the hands of numerous wholesalers and retailers.

Major Elements in Consumer Demand.—Producers must think of five major elements in consumer demand: the time at which that demand becomes effective, the place at which it becomes effective, the quantity of products demanded, the quality demanded, and the prices which consumers are willing to pay. They must think of when they will make their sales, where they will make their sales, how much they will sell, the quality of merchandise they will sell, and what they can get for their merchandise. All these factors are determined by the pattern of consumer buying habits. Seldom can a producer forecast exactly what the consumer demand will be, but, unless he can do so with a fair degree of accuracy, the risk of loss is very great.

His forecast need not be a pure guess. From the sum of his experience the retailer knows that consumer demand will vary by the time of day, by the day of the week, and by the different seasons. Wholesalers and manufacturers also know from experience the seasonal fluctuations of demand and, hence, guide their business operations accordingly. Experience also guides the businessman in gauging quality and quantity preferences. The intelligent use and interpretation of business experience, however, is not the easiest task which confronts the marketing executive.

Who Buys the Merchandise?—When we speak of consumers we really mean women. It has been estimated that women, alone or in the company of men, buy 96 per cent of the dry goods, 98 per cent of the women's clothing, 96 per cent of the home furnishings, 99.5 per cent of the food, and 90 per cent of the drugstore merchandise purchased in this country. They purchase half of all the goods sold at retail and they share in the purchase of another quarter. Men may control the purchase of men's clothing, but even for merchandise of this type it has been estimated that women purchase 11 per cent and share in the purchase of 23 per cent. With few exceptions, therefore, producers, in thinking of their markets, must think in terms of women and their buying habits. They must plan their products for women and their needs and must sell their products in the way in which women want to purchase them.[1]

They must give consideration, therefore, to women's tastes in merchandise, to how they want to purchase merchandise, to the stores in which they like to purchase, and to the services which they expect to accompany the merchandise. These buying habits have been altered during the past 25 years as a result of changes in the living habits of women. More women work outside the home. The interests of women outside the home have increased. Mechanical aids to housekeeping have been introduced. Women have a more scientific interest in the merchandise which they purchase. The manufacturer who sells to women must keep these developments in mind and plan his marketing program accordingly.

[1] Ways in which men and women differ in making purchases are discussed in Wyand, *op. cit.*, pp. 192–194.

Why Merchandise Is Bought.—An important part of the task of understanding the buying habits of consumers is the analysis of the motives leading to purchase. A producer must know why people buy his product and what motives are usually dominant in the purchase of similar products. Only if he knows this can he manufacture and market a product which will be adapted to the desires of consumers, and only if he knows consumer buying motives thoroughly will he be able adequately to promote his product through advertising and salesmen.

Consumers buy merchandise for a great many reasons. A glance at any of the leading magazines will show in their advertising pages appeals to as many as 25 different buying motives. Some are rational, others are emotional, but all are designed to interest consumers in merchandise and to lead them to purchase. It has generally been observed that, in the purchase of goods designed for use by industry, rational buying motives[1] are appealed to, while, in the purchase of goods for use by the ultimate consumer, appeals are made to emotional buying motives.[2]

In selling to industrial users a manufacturer will describe how his product will save money for the user, how it will do the work more quickly or quietly, or how it will accomplish more work in a given time period. He will point out how the use of his product will increase the efficiency of labor or how its longer life will permit more continuous operation of large-scale industry.

In selling to the ultimate consumer, however, advertisers are likely to appeal to their emotions, to the desire to have the same things which other people have, to the wish to be the first in a given locality to possess a new product, to fear of sickness, or to the desire to be attractive. Motives more emotional than rational are constantly used in selling to consumers who have little ability to measure the value of merchandise. Appeals to promote health, protect helpless dependents, emulate those with higher incomes, and increase educational opportunities are frequently employed. Consumers generally do not think objectively about, and are not able to measure the value of, the

[1] An appeal to rational buying motives is an honest and direct appeal to reason and common sense.

[2] An appeal to emotional buying motives is an appeal to the imagination, to the sex instinct, to the desire to be preeminent, to family love, to fear, or to any other of the irrational instincts and response patterns.

products they purchase in terms of dollars or of profit and loss. They are very conscious of their competitive position in a community, and their reaction to the purchase of most products is likely to be in emotional terms. They want to own those things which are possessed by the social or economic leaders of their communities. They want to "keep up with the Joneses."

Building a Marketing Program.—How can a manufacturer build his marketing program beginning with the final consumer? How does he find out about the desires and needs of consumers? The Bureau of Foreign and Domestic Commerce has published a check list of the study required by a manufacturer prior to a capital investment in the production and marketing of a new consumer product.[1] This publication points out that the first source of information must be the market for the product. Who will use it? What class of people? What is the geographic location of the market? What is the income of the potential users of the new product? What areas contain the major part of the market? What is the present consumption of comparative products? The analysis must then turn to the group of wholesalers and retailers who assist in bringing the product to the consumers. It must go on to examine the relation of the producer to wholesalers and retailers. It must include a study of competition, of buying policies, of the channels of distribution which may be used, of the methods of sales promotion which it may be desirable to employ, of the organization and management of the sales force, and of many other problems in both production and marketing. In every case the analysis undertaken by the manufacturer and all his thinking must begin with the final consumer of the product.

The manufacturer or producer must know the buying habits of the final consumer before he can expect to market his product successfully. This is as true for the farmer as it is for the manufacturer. It is as true for the retailer and for the wholesaler as it is for the manufacturer. Extensive advertising campaigns and skillfully planned selling programs will achieve little success if the product is not designed to fill the needs of the ultimate consumer of that product, or if it is sold in the wrong market, at

[1] "Check Sheet, Introduction of New Consumer Products," Bureau of Foreign and Domestic Commerce, Market Research Series No. 7.

the wrong price, in the wrong package, or through the wrong retail stores.

Studying Consumers' Desires.—The General Motors Corporation[1] is only one of a number of outstanding manufacturing concerns which have constantly followed a program of consumer analysis with the hope of adapting their products to the needs of consumers. A large manufacturer of toilet preparations and druggists' supplies carried on a market survey which was typical of surveys undertaken by many other manufacturers.[2] In analyzing the market for a new facial cream this manufacturer sponsored a field investigation which included a survey of all the brands on the market, of the extent of consumer knowledge of the various brands, of customary prices and the extent of price-cutting practices, of distribution outlets through which consumers were accustomed to purchase face creams, of the factors influencing sales (the importance of the appearance of the jar, the scent of the cream, the influence of advertising and window display, and of price), of the seasonal trend in sales, and of much other information relating to the sale of the new product. Only after a very careful analysis had been completed in this fashion did the manufacturer feel safe in proceeding with the production of the new cream.

There is hardly a manufacturer or a retailer who is not aware that this process of thought must be uppermost in his mind and that he cannot sell what people do not want to buy.[3] Retailers are constantly employed in ascertaining the needs and desires of consumers. Grocery chains send out interviewers to question consumers about their buying habits, brand preferences, and the services which they expect with their purchases. Department stores maintain style scouts in the leading style centers. They check the fashions which are being worn in the cities in which they are located. They accumulate records of consumer queries

[1] A description of their method of consumer analysis is found in Henry G. Weaver, Consumer Questionnaire Technique, *The American Marketing Journal*, July, 1934, p. 115.

[2] Tosdal, Harry R., "Problems in Sales Management," p. 187, McGraw-Hill Book Company, Inc., 1931.

[3] Possibly this is what a well-known advertising agency had in mind when it stated in one of its own advertisements, "no amount of advertising will sell a product that cannot be sold without advertising."

for merchandise not carried in stock. They employ comparison shoppers to maintain a check on merchandise offered by competing stores which may be satisfying consumers' desires.

Results of Studying Consumers' Desires.—Manufacturers are constantly engaged in ascertaining by means of mail questionnaires and field interviews the exact nature of the consumer demand for their products. They do this for both established products and new products. They experiment constantly with shifts in prices, with the use of new outlets, with new packages, and with different types of advertising and copy appeals. Without this analysis of consumer demand they would often be helpless to interpret the sales results which they have secured. A manufacturer of tooth paste, for example, could not secure satisfactory sales. The ingredients had been checked many times and were entirely satisfactory. Both the package and the price had been found to compare favorably with the packages and prices of competing products. It was only after some time had passed that a series of consumer interviews revealed that the lack of success was due to the taste of the tooth paste. Not until then did the manufacturer realize that consumers generally buy tooth paste for taste. A manufacturer of face powder was unable to explain his poor sales until consumer research revealed that women did not care for the scent of the powder. A manufacturer of flour was dissatisfied with consumer response to his product, and more than a year elapsed before he discovered that his package was inconvenient to use in the kitchen and hard to close after it had been opened. A manufacturer of a household cleanser had very small sales volume until he discovered that in trying to sell his cleanser through drugstores he was using the wrong type of retail outlet. Women were accustomed to purchase cleansers in grocery stores, and the product could not be sold successfully in drugstores. In every case, analysis of consumer buying habits yielded information which increased sales and profits.[1]

Merchandise Classification.—The classification of merchandise with respect to consumer buying habits has often been helpful in organizing a marketing program. One such classifica-

[1] Other examples of the results of consumer research can be found in Frank R. Coutant, Research as an Aid to Pricing and Production, *The American Marketing Journal*, July, 1934, p. 119.

tion[1] lists all goods in two broad divisions: industrial goods and consumers' goods. The industrial goods classification includes all types of goods sold to industry: raw materials, fabricating parts, machinery, and accessory supplies. The consumers' goods classification includes all goods sold to ultimate consumers for personal use. Consumers' goods are further divided into convenience goods, shopping goods, and specialty goods. Convenience goods include such merchandise as canned groceries, tooth paste, and cigarettes—all merchandise of low unit price, frequently purchased. Consumers prefer to purchase convenience goods as easily as possible. They like to buy in neighborhood stores. They usually do not compare prices and quality in several stores before purchasing.

Shopping goods include such merchandise as women's clothing, men's medium-priced hats, and shoes. Consumers like to purchase this type of merchandise only after examining the offerings of several stores and comparing prices, styles, and quality. Specialty goods include such merchandise as automobiles, expensive radios, and high-priced men's shoes. In buying specialty goods consumers know exactly what brand they want to purchase. The purchase is usually made infrequently. Consumers are willing to travel some distance to make the purchase. They will not readily accept substitutes.

Consumer buying habits, as indicated by this division of consumers' goods into classifications, influence the marketing programs of the manufacturers of consumers' goods. Manufacturers selling convenience goods attempt to place their merchandise in almost every retail outlet. Selling to numerous small retailers, they often are compelled to sell through wholesalers, because of the high cost of selling inexpensive merchandise directly to small purchasers. Manufacturers selling shopping goods attempt to place their merchandise in only a few stores. Manufacturers selling specialty goods frequently sell to only a single store in each city. Direct sale from manufacturer to retailer is, therefore, much more common in the case of shopping and specialty goods. Intensive distribution is not necessary in the case of shopping goods because consumers usually compare the merchandise offered by several stores before purchasing.

[1] First presented by Melvin T. Copeland in his "Principles of Merchandising," pp. 13, 16, McGraw-Hill Book Company, Inc., 1924.

Nor is it necessary in the case of specialty goods because consumers know exactly what brand they want to purchase and willingly travel to the single store in the community which sells that brand.

The Modern Consumer Movement.[1]—A number of limitations to the control of distribution by consumers should be noted. The consumer is not an efficient purchaser, partly owing to carelessness, partly to lack of skill in purchasing. She has neither the time, the means, nor the ability to study the quality of merchandise. She seldom gets the most for her money.[2] Hoyt says,[3] "Consumers are ignorant and easily played with." The average consumer should think how he spends as well as how he earns. Yet consumers often purchase without adequate knowledge of merchandise quality or comparative prices. They are in no position to test merchandise before purchasing. They are often unaware of alternate and more attractive sources of supply. Even after using merchandise they may be unable adequately to appraise its value. There is a vast amount of waste in buying, arising in part from ignorance, in part from lack of testing facilities, in part from the predominance of emotional buying motives, in part from the desire to purchase in the most convenient outlet.[4] Out of the realization of this wasteful buying has come a recognition of the value of education in buying methods.[5]

One of the most interesting recent developments and one of the most important in its effect upon marketing procedure has been the general movement sponsored by professional consumer groups,[6] by various organizations,[7] as well as by governmental

[1] This movement is discussed in an interesting way by D. E. Montgomery, in The Consumer Looks at Competition, *The Journal of Marketing*, January, 1937, p. 218.

[2] W. B. Pitkin in "The Consumer—His Nature and His Changing Habits," discusses at length this inefficiency of the consumer.

[3] Hoyt, *op. cit.*, p. 104.

[4] For specific examples, see S. Chase and F. J. Schlink, "Your Money's Worth," The Macmillan Company, 1931; A. Kallet and F. J. Schlink, "100,000,000 Guinea Pigs," Vanguard Press, 1932; M. C. Phillips, "Skin Deep," Vanguard Press, 1934.

[5] A discussion of the education of consumers is found in Hoyt, *op. cit.*, Chap. XXXI.

[6] These include Consumers' Research, Consumers' Union, and the Inter-Mountain Consumers' Service.

[7] The National League of Women Voters, The American Association of

units,[1] to increase the knowledge of merchandise possessed by women as consumers[2] and to increase the amount of merchandise information offered by manufacturers to consumers.[3] Other projects in which the various consumer organizations have shown interest are milk prices, general food prices, standardization and compulsory grade labeling of food products, and standard weights and measures. The development is in its earliest stage at the present time and probably will spread both in numbers and in the intensity of the interest of association members in the future. The implications of this movement for those engaged in the marketing process are, of course, tremendous. Many manufacturers and retailers are providing greatly increased information concerning the merchandise sold in retail stores. Others are considering the possibility of grade labeling and of offering more detailed and exact information on the labels of food products.[4] Government recognition of the movement is developing and may find its outcome in legislation affecting advertising practices, packaging, and standard weights and measures.[5]

University Women, and The Federation of Women's Clubs have interested themselves in various phases of the consumer movement.

[1] The Federal government, as well as several states, helps the consumer by testing products and reporting on these tests to consumers. There are bureaus within the U.S. Departments of Agriculture, Labor, Commerce, and the Interior which aid in this movement. The state of North Dakota performs an outstanding service for its consumer citizens. Each year the North Dakota Regulatory Department issues a bulletin which reports on a wide variety of products. The consumer's interest may force other states to render similar services, especially for food, drug, and cosmetic products.

[2] "Her capriciousness, indecision, and the unreasonable demands for more and more services, and the returned goods evil are largely the result of lack of information."—JULES LABARTHE, JR., Standards for Consumers' Goods, *Boston Conference on Distribution*, 1937, p. 35.

[3] The type of information needed by the consumer is discussed by Ruth O'Brien in Sound Buying Methods for Consumers, *The American Marketing Journal*, April, 1935, p. 104.

[4] The California Packing Company, packers of Del Monte brand foods, have recently begun the use of labels which state in detail the size of the can, the net contents, the size of the fruit or vegetables, the number of pieces in the can, and the type of liquid. Other leading food packers have initiated similar changes.

[5] A description of what has been done by the government, professional agencies, and consumers' organizations to protect the consumer is found in Hoyt, *op. cit.*, Chap. IX.

The so-called "consumer movement" to a certain extent has created an unjust suspicion in the minds of many women consumers toward all advertised or branded merchandise. By pointing out that some products are inferior, that some advertising is misleading, and that occasionally the consumer has been tricked into buying, the false impression has been created that all merchandising is at fault. This is far from true, since both the manufacturer and the retailer know they must have the consumer's confidence if they are to continue through the years to serve her. The consumer movement will have performed a useful service if it helps the producer and distributor to understand the needs of consumers and to meet them more satisfactorily.

In every case modern marketing practice first directs attention to the consumer, her buying habits, her tastes, and her desires. The development of the product and the selection of the marketing and promotional program is firmly based upon this knowledge.

PART II

CHANNELS OF DISTRIBUTION

Goods move to market in different ways. The story of these methods of distributing merchandise is the story of individual products and individual marketing situations. Beneath this complexity of procedures may be discerned a number of basic principles of distribution. The principles themselves are not permanent, but they possess more of the character of permanence than do the vast phenomena of marketing practices for different commodities.

Part II contains seven chapters describing the channels of distribution, the agencies which assist distribution, and the problems of operating those agencies. Part II contains the story of distribution as it might look if stretched out in a single long line. Not all distribution is like this. At various points in the line production takes place. Goods move from raw material sources to factories. Production occurs. Distribution begins again with the movement of goods to consumers. In distribution itself short cuts may be taken. Look for the underlying principles rather than for surface facts. Remember that distribution deals not only with merchandise and machines, but also with human beings. Remember above all that distribution is carried on for the service of human beings.

CHAPTER III

HOW GOODS MOVE FROM THE FARM

"The farmer fills the American market basket."
"The farmer can't fill his own market basket."
"The farmer is the foundation of our economy."
"The farmer is a poor businessman."
"The farmer is victimized by the marketing process."
"Everyone tells the farmer what to do—and then he doesn't do it."
"The farmer is all right—what he needs is to be left alone."

Characteristics of Farming and Farm Products.[1]—This is a picture of farming: 6 million scattered farms worked by owners or tenants; the quality and quantity of their crops at the mercy of wind, rain, sun, cold, heat, and insects; production scattered and products perishable, far from major markets, needing standardizing, grading, financing, and transportation; fixed costs high and prices swinging wildly caught between stable demand and volatile supply. This is the foundation of the nation's market basket. This is where America goes to dinner. To some it is a way of life; to others a one-crop specialized industry. Always it is an industry bursting the bonds of scientific control, defying management, belying forecast and plan. This is the other end of the marketing cycle: poles away from the consumer who sees the product of our farms as food or, even more remotely, as the raw materials of his finished products. This is where the physical process of marketing begins.

Longer than any other unit of production the farm has remained economically independent. It is a production unit with increasing costs feeding an inelastic demand.[2] Against this difficult

[1] Malott, D. W., "Problems in Agricultural Marketing," pp. 1–6, McGraw-Hill, Book Company, Inc., 1938. The introduction gives a good picture of the varied problems faced by those marketing agricultural products.

[2] Owing to the inelastic demand, a small increase in the volume of production may cause a marked decline in price.

background the farmer, separated often by thousands of miles from the great consuming centers, sells his product at prices over which he has no control. Both quality and quantity of what he raises are at the mercy of the weather, atmospheric conditions, and insect pests.[1] When he plants he does not know what price will prevail at harvesttime. He cannot forecast his income. He cannot predetermine his sales volume. He cannot budget his costs, nor will they yield to low selling prices so as to guarantee him a profit.[2] If the price at harvesttime is low, seldom can the farmer withhold his crop from the market. Governed by the perishability of what he raises, he must offer his supply at the ruling price and accept what he can get. Usually there are a number of different channels through which he may market his product.[3] It takes a keen business judgment to weigh the advantages and disadvantages of each.

The farms are scattered and their products nonuniform. The marketing process beginning at the farms resembles the picture of many streams flowing into a large central reservoir (the central market) and then dividing again into many streams flowing toward the consumer. Before farm products can be distributed to consumers, they must be concentrated in the central reservoirs of the major wholesale markets. In part that concentration process is necessitated by savings in transportation costs made possible by carlot shipments.[4] In part it is brought about by the need for grading and standardizing farm products,[5] processes which can be carried on more effectively in central markets than on the individual farms. In part it is due to the superior financing facilities of large organized central wholesale markets where

[1] This is in marked contrast to the manufacturing industries.

[2] Many of the farmer's costs are fixed costs (taxes, insurance, etc.) and stay the same whether he has a large crop or a small one.

[3] Malott, *op. cit.* Cases beginning on pp. 17 and 41 show the problem presented by alternative marketing channels.

[4] Since most farm products are very bulky in relation to their value, the cost of transportation is very high. Thus, out of the price paid by the consumer, a large proportion is due to the cost of transportation.

[5] Machines can produce standardized products, but nature does not. Even the cattle from one farm and the apples from the same orchard will have varying qualities. Yet the packer desires to purchase cattle of the same grade and the consumer wants his box of apples to be of the same size, color, and shape. Thus there is always the problem of grading agricultural products.

buyers and sellers can assemble and minimize the risks of price fluctuations.

The marketing process which begins on the farm is also affected by the seasonal nature of agricultural production.[1] There is no constant flow of farm products to market; at certain periods of the year there is a superfluity of supply and at other periods a dearth. Great strains are placed on marketing agents and agencies in handling the erratic flow of farm products. The producing areas are limited, and attempts to increase or reduce production may not be effective for a period of from several months to several years. Efforts by the farmer to control his production in accordance with prevailing prices may be fruitless, since, by the time the change in quantity produced becomes effective, the price situation which encouraged that change has altered.

Increasingly in the past generation farming has become a specialized industry. One-crop farming is a common practice. Failure of that crop or the presence of an unsatisfactory price may make the entire season one of loss rather than profit.

Concentration of Farm Products.—The typical farm is located at a great distance from the major consuming centers.[2] Beef cattle are raised, on the average, 650 miles from their consumption points, hogs 250 miles, and sheep more than 600 miles. California fruits and vegetables are marketed in New York City. Pacific apples are sold on the Atlantic seaboard. Cotton raised in Gulf states is sold throughout the country. Crops can be raised only on farm lands wherever they may exist and where climatic conditions are favorable; industrial enterprises, within certain limits, may locate anywhere. The tendency for industrial enterprises to concentrate in certain parts of the country, because of favorable transportation facilities, access to raw materials and markets, and the presence of the necessary labor supply, has contributed to the complexity of the task of marketing farm products.

[1] The seasonal production of farm products and their fairly even consumption throughout the year makes the storage function an important one. The bulkiness of these farm products makes these costs also high as a percentage of the price to the consumer.

[2] This accounts for the farmer's interest in transportation, since he must rely on an efficient transportation system to get his products to market. He wants the facilities of this system to be available to him when he needs them and at a reasonable cost.

So it is that farm products proceed to the consumer by way of large central wholesale markets where the crops of small individual farms are concentrated and where a number of other activities are carried on. The typical farm is too small to permit economical processing of farm products. It is also too small for the farmer to attempt to sell his products directly in the central market. The individual farmer with his small crop lacks necessary market contacts. He needs immediate cash payment. He does not have the time to supervise selling in the major markets. His crop is too small to interest large-scale buyers. Transportation rates are another factor helping to strengthen the need for concentrating farm products. Rates on carlot shipments are relatively lower than rates for less than carlot shipments. To secure these savings in transportation rates, it is usually necessary to concentrate farm products at local shipping points so that carload lots may be moved to central wholesale markets.

In yet another way is the farmer handicapped by his distance from the major consuming centers. Removed by hundreds of miles from the large city markets, without either information about, or familiarity with, central market procedure, he is compelled to turn the task of marketing his produce over to others—specialists in this function. In most cases the activities and interests of farmers stop with the sale of their products to local buyers.[1] This is the first phase of the concentration process which has been compared to the confluence of many streams into a large central reservoir. It is a process largely carried on by specialized agents, rather than by the individual farmer.

Classes of Markets.—In the process of marketing farm products a number of concentration points are utilized. These have different names, and, to prevent confusion, it is important to distinguish between them.

It is possible to divide all the concentration points or markets into four broad classifications:

1. *The local market*[2] to which produce is hauled from farms. This point may be only a shipping point or may serve as an actual market with purchase and sale activities.

[1] Cooperative marketing provides an exception to this statement, since this form of marketing carries the farmer's interest beyond his own neighborhood out into the central markets.

[2] This is sometimes described as a country market.

2. *The central market*[1] where shipments from local markets are concentrated.[2] Here the process of concentration reaches its height, and the process of dispersion begins.

3. *The secondary wholesale market* where distribution to retailers occurs.

4. *The retail market* where produce is sold to consumers.

The local market may be offered as a general descriptive term applied to the first country concentration point. Here the producer exchanges his merchandise for ready cash. Standardizing and grading may begin. Storage may occur. More important, transportation is available for bulk freight movements from the local market to the central wholesale market.

The central market[3] is the major reservoir or concentration point for farm products. Here standardization and grading are completed. Goods may be stored. Contact is effected between the agents and agencies connected with the concentration phase and those connected with the dispersion phase of the marketing of the farm products. Here are located the major risk-bearing and financing functionaries. The process of dispersion, the breakup of shipments of produce begin here. There is some indication of a lessening in importance of these central markets.[4] In livestock marketing, for instance, we find the packer often going out to the producer to buy rather than waiting for the producer to ship his livestock to the central markets.[5]

The secondary wholesale market is one step nearer to the ultimate consumers of merchandise, and often represents the end of bulk freight movement. Breakup of shipments occurs here. Retailers purchase here from wholesalers for distribution to consumers.

The retail market is the retail store. Further breakup of merchandise shipments takes place for consumer distribution.

[1] This is sometimes spoken of as a primary or terminal market.

[2] E. A. Duddy and D. A. Revzan, The Changing Relative Importance of the Central Livestock Market, *The Journal of Business*, July, 1938, Chap. I, tells how the central market is organized and how it operates.

[3] Malott, *op. cit.*, pp. 160–165, gives a short description of a central wholesale market, the Chicago Live Stock Market.

[4] Duddy and Revzan, *op. cit.*, Part 2.

[5] Malott, *op. cit.*, pp. 182–195. This case gives a good description of "direct marketing" of livestock. (This term refers to the buying of livestock at other than central markets.)

Again there is transfer of ownership. This is the end of the distributive process.

Not all products follow the same pattern from farm to consumer, and in the case of different trades a variety of names may be applied to the markets. Speaking generally, however, it is possible to visualize these four broad classifications of markets utilized in the distribution process for almost all types of farm products. A single city may serve as more than one type of market. Chicago furnishes an example of a city which serves as all four types of markets. Local truck farmers may bring produce directly to the city. It is a central market for livestock. It is a secondary market for practically all manufactured and agricultural products. And in common with any town or city it is a retail market. A city may be a central wholesale market for certain products, may be a secondary market for other products, and will, of course, have many retail markets. Transportation and financing facilities, storage space, and nearness to producing and consuming markets, all are elements necessary for a central market. Secondary wholesale markets need these elements to a lesser extent because of the smaller volume of merchandise handled.

Sale to Local Middlemen.—A great many farmers engage in direct selling of their products. This may be to the ultimate consumer by means of roadside markets, huckstering, the retail public market, or selling by mail. It may also be to industrial consumers such as canning plants. However, the great bulk of farm products are marketed through middlemen. A number of different local middlemen operate in the farm areas. They purchase from individual farmers and sell to agents in the central wholesale markets. They initiate the concentration process and relieve the farmers of responsibility and risk for the marketing of their produce.

One well-developed method of sale in this classification is by individual farmers to local buyers. Local buyers, for example, purchase livestock from small producers and assemble them into carlots for shipment to the central markets. Country elevators buy wheat from farmers and sell in turn to elevators in the central markets. In addition to purchasing wheat, the local elevator operators may perform many other services, such as inspection, grading, weighing, storage, cleaning, conditioning, and mixing.

These local buyers are really country merchants whose major function is to relieve the farmer of the difficulty of supervising and guiding the marketing of his small portion of the total crop. The country general store in many cases takes the farmer's produce in trade. Tobacco warehouses, potato warehouses, cream and milk stations are other examples of local buyers.

Another well-defined method of sale is to the traveling buyer. In certain sections of the country traveling buyers have established regular routes for purchasing eggs, poultry, butter, and similar products for resale in the major wholesale markets. In many instances the traveling buyers represent large city wholesalers or large chain-store companies or processors. They travel through the farming territory, following the cycle of the various crops. Occasionally they contract in advance of the harvest to purchase the entire crop of the farm. Like the local or resident buyers, the traveling buyers relieve farmers of all risks except those connected with production.

Still another well-defined method of sale is through the producers' cooperative selling associations. An outstanding example of this method of sale is found in the milk industry. In 1935 there were almost 9,000 cooperative selling associations with 2,500,000 members. The total value of products handled by these associations during 1934–1935 amounted to over $1,300,000,000.[1]

It should be noted that these cooperative selling associations do not abolish any marketing functions or activities. Whatever is done by the local or traveling buyer or the central wholesaler must also be done by the cooperative selling association which attempts to replace them. They strengthen the position of the individual farmer so that he may obtain a higher price for his crop, and they may retain for the individual farmer the profits normally earned by the independent middlemen. To do this, however, they must perform the marketing activities as efficiently as they are performed by independent middlemen. Unless they can do this, they sacrifice a large part of their potential benefits.

Sale to Retail Stores.—Still another well-developed method of sale is direct to retail stores. In some localities retail butchers

[1] Fetrow, Ward W., Cooperative Marketing of Agricultural Products, Farm Credit Administration, Cooperative Division, Washington, 1936.

purchase livestock direct from farmers. Chain-store companies often buy fruits and vegetables from individual farmers and ship them to their stores. On the whole, however, only a small portion of all farm products is marketed in this manner. The reasons why this method of sale has not been utilized to a greater extent: are (1) the supply is not dependable as to either quantity or quality, since the individual farmer usually is not equipped to grade his own produce; (2) it is too expensive for the individual farmer to provide the daily shipments demanded by retailers; (3) the individual farmer is in no position to extend credit to retail stores; (4) the retailer cannot depend upon one farmer to supply all his needs and so must maintain relations with a number of producers; and (5) the individual farmer often cannot provide a sufficient quantity of the particular quality demanded. Of all these difficulties perhaps the major one is the failure of adequate grading to be performed under this method of sale.

Sales to Middlemen in Outside Markets.—Some large producers of fruits and vegetables sell direct to purchasers in central markets. A producer of cotton may sell his crop in one of the central markets through a cotton factor[1] or commission house.[2] A livestock producer may consign shipments to commission men in the central market.[3] This method of sale may also be used for other crops. The commission method of marketing is frequently resorted to when the shipments from individual farms are too small and irregular to attract local buyers, when the crop is not standardized, when the crop is perishable and there are no local buyers available, and when the market at the destination point is highly organized.

[1] "A type of commission merchant who usually advances funds to the consignor. His work consists: (1) in financing the operations of the shipper who may be a grower but who is usually a country buyer or merchant; (2) in warehousing or storing the goods; (3) in grading; (4) in selling the goods." —Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

[2] "An agent (functional) middleman transacting business in his own name who exercises direct physical control over the goods consigned to him and negotiates their sale. He usually enjoys broader powers as to prices, methods, and terms of sale than does the broker although he must obey instructions issued by his principal. He generally arranges delivery, extends necessary credit, and collects."—*Ibid.*

[3] Duddy and Revzan, *op. cit.*, pp. 10–13.

In recent years the practice of selling through commission agents of various types has declined in favor of sale direct to wholesalers often through their traveling buyers. The marketing process for many farm products was so hazardous formerly that few buyers were willing to incur the risk involved in outright purchase without paying such low prices that farmers were unwilling to sell to them. In recent years, with production more specialized and on a larger scale, crops have been standardized to a greater extent and shipped to market in graded carlots. Increasing distances between producing areas and consuming markets have made the grower less inclined to entrust to distant commission men the sale of their products. Closer relations have been established between producers and central-market wholesalers so that outright sale is becoming more popular.

In the central markets buyers and sellers are brought together. Ample storage space and facilities for handling agricultural products are available. Financing and market news services are offered. Good transportation from producing areas and toward consuming areas is necessary for the movement of the actual product. A city which hopes to be a central market must have a constant body of buyers and sellers, it must provide physical provisions for handling the goods, and must facilitate the exchange of title.[1]

Auctions for Farm Products.—Certain farm products,[2] notably fresh fruits and vegetables[3] and tobacco,[4] are commonly sold at auction in the central wholesale markets. This method of sale provides a quick way of disposing of farm products for cash. The auction houses store products and often grade and catalogue them, but their major function is to provide facilities for the rapid transfer of products from producer to wholesale purchasers. At

[1] Chicago offers an example of a central market with these facilities.

[2] In recent years there has been some development of markets for the auctioning of livestock at country points in the Middle West.

[3] Park, J. W., American Fruit and Vegetable Auctions, *U.S. Department of Agriculture Circular* 250, 1932.

Gardner, K. B., Terminal Fruit Auctions, *Farm Credit Administration Bulletin* 29, 1938.

Malott, *op. cit.*, pp. 76–83.

[4] Malott, *op. cit.*, pp. 62–65.

Rowe, H. B., "Tobacco under the AAA," Chap. II, Brookings Institution, 1935.

an auction the shipper is represented by a salaried or commission agent. Produce arrives daily, is catalogued, and displayed for inspection by buyers. Sales are made from catalogue numbers with the auction company charging a relatively small proportion of the sale price as a fee for its services. When sufficient volume is offered to maintain a constant flow of business, sale by auction is an inexpensive method of marketing perishable products. It may not be so attractive from the buyers' point of view, however, because of the time consumed by individual buyers waiting to purchase lots of produce in which they are interested.

The main abuses of the auction sale are misrepresentation by the auctioneer, private sale in advance of the public auction, withdrawal of certain lots of produce in unfavorable price situations, and the combination of buyers. These abuses are being eliminated under the precautionary procedure of the modern auction company.

There is a difference of opinion as to whether auctions make for stable or fluctuating prices; what they do offer at all times is quick disposal of perishable products. The method of sale may result in the securing of a low price for produce of poor quality. It may also result in nonstandardized prices, since purchase may be in small lots. In the prevention of market gluts caused by incapacity of buyers to assume title to sudden arrivals of merchandise, the auctions may be said to limit extreme fluctuations of prices.

Commission Dealing in Farm Products.—The commission dealer in farm products is distinguished by one characteristic: he does not take title to the merchandise he handles, but rather he acts solely as an agent for his principal. The commission agent or the commission house may perform many services in connection with the marketing of farm products. He helps to finance the sale of farm products; he buys and sells future contracts; he supplies market information; he insures fair treatment for the client; and he assists in supervising transportation arrangements. He usually has excellent market connections, and his selling costs are low. At the conclusion of the sale the commission agent collects the proceeds, deducts the necessary expenses, including his own profit, and credits the balance to his principal's account. Goods are usually sold on a consignment basis when shipments are small and are offered at such infrequent intervals as to be unattractive to local buyers, when goods cannot be standardized

or graded locally, and when the market at the destination point is large, well organized, and supported by many buyers.

The practice of selling through commission agents has been decreasing and that of direct sale to wholesale purchasers has been increasing in recent years. From time to time there has been some suspicion of malpractice by commission men, but in general the reasons leading to the change have centered around improvements in the whole marketing procedure, including swifter and more efficient transportation and better organized central wholesale markets. In addition, the growth of the practice of grading at local shipping points has enabled country shippers to secure the confidence of large wholesale buyers. Commission houses still have a place in handling the sale of the many farm products which remain unstandardized or which are sold irregularly in very small amounts.

Future Trading in Farm Products.—One of the most difficult and fascinating problems in agricultural marketing is the study of price movements. The relation between price and profit for the farmer is perhaps more direct than in most other industries which have relatively flexible costs. We shall return to the study of prices later in this volume[1] and take up in greater detail the analysis of how prices are evolved. At this point we shall attempt merely to describe briefly the part which price plays in marketing farm products. The description will not be complete, but it may suggest some of the problems which are involved and some of the effects upon the farmer.

What factors influence the formation of prices of farm products? As is usually the case, a complexity of forces are at work. Part of the influence is future trading in farm products. Like the question of prices, that of future trading will be taken up in greater detail in the chapter on Risk. At this point only a brief description of future trading will be offered.

Future trading in farm products is made possible by the existence of organized markets where standardized goods may be purchased and sold. Trading in futures is not carried on in actual merchandise but in the purchase and sale of contracts calling for delivery at future dates. The future price of wheat today is the price today for contracts calling for the delivery of

[1] Chapter XIV of this text.

wheat at a specified future date. The future price, therefore, is usually higher than the cash price (the price for actual wheat delivered today) by the cost of storing that quantity of wheat for the period between today and the delivery date specified in the future contract, plus interest and finance costs, and plus other incidental charges which may be incurred in storing wheat.

This divergence between cash and future price may be called the "normal spread." The actual spread between cash and future prices may be greater or less than the normal spread. Such movements away from the normal relation between the two prices occur as a result of special supply and demand conditions. A large supply of wheat in storage in Chicago elevators may depress the cash price, while drought conditions existing at the same time may forecast a limited harvest and thus a smaller future supply. This latter outlook will operate to force up the future price of wheat. The spread between cash and future price widens. A dearth of cash wheat and the prospect of an abundant harvest will raise the cash price and depress the future price, with a consequent narrowing of the spread.

To carry on trading in future contracts, there must be available standard grades of nonperishable merchandise which will always be offered in sufficient quantities to fulfill contracts. There must also be a volume large enough to support continuous trading so that at any price buyers and sellers will always be available. The rules for trading in futures are established by the commodity exchange on which the trading proceeds. These rules usually cover such points as the definition of contract grades of the products to be traded in, the requirement of adequate margins, relations between the individual firms engaged in trading, requirements for delivery of merchandise on contract, and the liquidation of damages on default. Future trading, therefore, is limited to those farm crops which can be readily graded. The important grains and cotton are among those commonly traded in on organized exchanges.

Since the cash price of a product and the future price are closely interrelated, usually varying by the cost of storage during the intervening period, the two prices generally move together. Under special conditions the spread between cash and future price may vary from the normal spread which is equal to the cost of storage. Just as the future price influences the cash price, so

does the future price influence the price paid to the farmer. In the case of wheat, for example, the cash price today for wheat is usually less than the future price by the cost of storing the given quantity of wheat for the given time period. Hence the price paid to a wheatgrower in Dakota is less than the cash price for wheat on the same day on the Chicago Board of Trade by the cost of transporting wheat from the local elevator to Chicago, plus the cost of storing wheat at the local elevator (including insurance, interest, etc.), and plus the profit of the local elevator. Thus there is a direct relation between the price today of future contracts for wheat on the Chicago Board of Trade and the price paid to the farmer by his local elevator operator. That relation is a complex one, however, inasmuch as the future price represents the aggregate of estimates of future production and the effect of future production on present production and supplies in storage. Future price influences cash price, and cash price influences future price.

Cost of Marketing Farm Products.—Other factors besides future trading influence the prices of farm products. One influence, of course, is the cost of marketing farm products. It has been estimated that more than 50 per cent of the price the consumer pays for bread goes to cover the cost of marketing that bread; 55 per cent of the price of meats and dairy products is needed to cover marketing costs; and 60 per cent of the retail price, it has been estimated, is required to cover the cost of marketing oranges. The costs of marketing various products are not similar, but whatever the cost may be, it exerts a direct influence on the retail price. The retail price of a product should be composed of three parts: (1) the cost of the product, (2) the cost of marketing the product, (3) the hoped-for profit.

A number of factors are included in the phrase "cost of marketing." One of them is the perishability of the product, including the amount of waste and spoilage which occurs between the farm and the ultimate consumer. This makes it necessary for merchants to secure prices high enough to compensate for the losses suffered as a result of waste. Another factor is the irregularity of supply, which contributes to marketing costs through the necessity of storing merchandise. A third factor is the volume of merchandise offered; fluctuations in volume make storage necessary and bring about unbalanced supply-demand relation-

ships. A fourth factor is the extent to which the commodity lends itself to grading; price schedules for ungraded merchandise are irregular and losses may be suffered as a result of buyers' unwillingness to pay for unreliable goods. Still another factor is the relation between the bulk of the product and its value; a product with large bulk and low value will assume a heavy burden of transportation costs. One more factor is the packaging required before the product can be sold to the ultimate consumer. So we see that a product which is grown at a great distance from a consuming market, which is perishable and requires swift transportation, and which has a relatively large bulk may have very high marketing costs. If this product also requires packaging, the cost will be increased. On the other hand, a product which is grown near its major consuming market, which is relatively nonperishable, and which does not require elaborate grading facilities or packaging may have very low marketing costs. For the first product the consumer may find as much as 50 per cent of the retail price going to cover marketing costs. For the latter product perhaps only 5 per cent of the retail price will be required to cover the cost of marketing.

Influence of Demand and Supply on Price.—Demand and supply conditions also influence the price of farm products. The demand for farm products used as food is relatively inelastic. We consume about the same total quantity of food in good times and bad, at high prices and at low. The demand for different products may vary according to the price, but the total demand for farm products does not vary. In a major depression consumers with curtailed incomes will purchase cheaper cuts of meat and will substitute other low-cost foods for meat in their diets. They still, however, consume about the same total quantity of farm products.[1]

The demand for some farm products has been experiencing a long-continued increase. This has been true, for example, of fruits and vegetables for a period of over 25 years. The demand for other farm products, such as wheat and the more expensive cuts of meat, has been following a long curve of decrease. Changes of this type are the result of basic shifts in the national

[1] For a detailed study of consumer buying habits in a depression period see A. R. Tebbutt, "The Behavior of Consumption in Business Depressions," Harvard Bureau of Business Research, 1933.

diet and reflect the switch from meat and bread to fruits and vegetables.[1]

Contrasting with the relatively stable demand which exists for most farm products used as foods, the supply of farm products is anything but constant. Production varies from year to year, governed by conditions beyond the control of the farmers. Most of the changes in supply are caused by the weather. There is no quick and accurate adjustment of the supply of farm products in response to price movements. If the price is high, the normal expectation would be that the farmers would increase the acreage planted and so increase the supply and eventually bring about a reduction in price. Any attempt by a farmer to follow this procedure may be met, however, by abnormal weather conditions which would destroy his entire crop. In other cases increased supply brought about by a rise in prices may not reach the market for several years. This is particularly true of the orchard crops. A farmer who increases his supply in response to a high price existing this year may find that, by the time he is ready to market his increased crop, the price has fallen. The same conditions inhibit action undertaken in response to a low or a falling price level.

Still another factor often influences the price situation: with relatively fixed costs, the farmer is constantly attempting to maximize his income. If prices fall due to an excess of supply over demand, rather than decrease his supply the farmer is likely to plant more in the effort to maintain his income at the same level. He is induced to do this because his costs will not be materially reduced if he should plant less. The result, of course, is that, as the price falls due to the excess of supply over demand, more and more is planted and the supply, rather than being reduced, becomes greater. At the same time, under conditions of inelastic demand, there is not much increase in the amount consumed even at the reduced price.

Normal supply and demand relations, therefore, exist in the marketing of farm products only in a rather limited field. It is generally true that over a long period supply and demand conditions find their equilibrium in price. During short periods,

[1] Advertising campaigns of such organizations as the California Fruit Growers' Exchange have played a part in this shift in the diet of consumers. Health movements and diet fads have played their parts, too.

however, the relation between supply and demand and price may frequently be abnormal. To determine the price situation existing for any crop at any time, a very careful analysis of supply and demand conditions is required. Often the potential future supply is of greater importance in its effect upon price than the actual supply, and so the effect of the price of future contracts exerts an important influence upon the cash price of farm prod -ucts, which may also be determined in part by the cost of marketing those products and by the conditions of supply and demand existing for those products.

The Movement of Farm Prices.—Other conditions may from time to time exert an influence upon the movement of farm prices. Often, vital information relating to either supply or demand is lacking. Frequently, products are not sufficiently uniform to be traded in on organized exchanges and may suffer from irregular marketing procedures. On the organized exchanges for farm products, supply and demand, present and future, roughly govern prices. For products which are not marketed through the organized exchanges, but under local and domestic conditions, there may be a great variety of prices for the same product in different local markets.

The relative prosperity of the farmer is soundly based upon one aspect of farm prices, the relation between the price he gets for what he sells and the price he pays for what he buys. Farm prosperity or farm poverty rest directly upon this relation and any dislocation of the relation between the two price levels may have very serious consequences. It has been said many times that the major cause of the present farm problem in this country is just such a dislocation of price levels. The farmer's income, expressed as the product of what he gets for what he sells, has fallen materially with relation to his outgo, expressed as the product of what he pays for what he buys. The general decline in farm prices which has brought about this condition has not, of course, been uniform. Prices of some products have declined more than prices of other products, and in such movements we can find part of the explanation for the decline in the consumption of meat and wheat and the growth in the consumption of fresh fruits and vegetables. Since 1921, however, the farmer's position has been on the unfavorable side of the two-price level relation. His real income has been reduced.

The question might be raised, why does not the farmer shift production from one crop to another so that he is always marketing a product which is selling at a relatively high price? In answer to this question, it should be pointed out that there is often considerable shifting in production among farmers engaged in mixed farming and truck farming. Farmers supplying fresh vegetables to near-by markets frequently shift production so as to increase their total incomes. The shift is much more difficult to make in the case of specialized farming. It may require a heavy investment to shift from dairy farming to the growing of wheat. Farm management under crop-rotation procedures also lessens the opportunity to shift production. Still another factor must be mentioned. The existence of a high price for one farm product may induce not only a few but many farmers to increase their production of that product. The shift may go too far. The result may well be a superfluity of supply so that, by the time the crop is offered to the consumer market, supply has far outstripped demand and the price is low.

All this discussion indicates the important part which the forecasting of farm prices plays in the marketing procedure. A number of government agencies are engaged in preparing forecasts of farm production by individual products. The farmer has continual access to this information. In view of what has been said of the hazards of farming, however, it should be clear that no great accuracy can be counted on. There has been much improvement in this work in the past few years, and certainly it is true that any increase in the information made available to the farmer will assist him in the management of his business. It may have some effect upon stabilizing farm prices and protecting farm incomes.

To a large extent the present farm problem is the result of the dislocations in farm prices brought about by the World War. At that time, with all the world clamoring to be fed, the American farmer went into the export business on a gigantic scale. Prices of farm products soared and so did the price of farm lands. Production was greatly expanded, often financed by mortgages taken at very high values. The postwar period has witnessed a rapid decline in the importance of the export market for the American farmer. Owing to the consequent excess of supply over the amount demanded in the domestic market, prices of

farm products have declined. Prices of farm lands have also fallen. The mortgages, however, have remained. Here is a condition of shrinking demand and falling prices, but with no decline in cost. The farmer has never sought to curtail the amount produced. His attempt rather has been to increase production in the effort to maintain his total dollar-income unchanged.

Government Aid to Agriculture.—The efforts of the government to aid the farmer date from the depression years of 1920–1921. Loans were made to farmers to assist them in financing their production. The government urged cooperation among farmers in the effort to reduce marketing costs. The Federal Farm Board was created in 1929 and entrusted with power to purchase farm products and withhold them from the market. The board urged farmers to reduce production, but the advice was ignored. It encouraged the growth of farmer-owned cooperative marketing associations and made loans to cooperatives on the basis of wheat withheld from market. It also bought wheat and cotton in the open market in the attempt to support the price. In two years it had accumulated wheat to the extent of almost 250,000,000 bu. and cotton to the extent of 3,500,000 bales, but prices continued to decline. Eventually the purchase of surplus products by the Federal Farm Board had to be discontinued.

In 1933 the Agricultural Adjustment Act was passed.[1] One part of the act attempted to outline a technique for production control, the other provided for marketing agreements to be applied to agricultural crops.[2] The production-control features of the act were ruled invalid in 1936. Marketing agreements have been written for a number of agricultural crops, designed to control the volume of crops reaching markets. Operation under the marketing agreements has produced a mixture of failure and success which can only be regarded as inconclusive evidence of the value of this type of control. Since 1936, agricultural legislation has taken the form of soil conservation, 1936, and compulsory marketing quotas for five basic farm crops, 1938.

[1] Malott, *op. cit.*, pp. 361–379.

[2] An excellent description and analysis of these agreements during the early years of the act is found in Edwin G. Nourse, "Marketing Agreements under the AAA," Brookings Institution, 1935.

Our entire experience with governmental attempts to raise farm prices and restore the parity of farm purchasing power indicates the necessity for thinking of prices and production simultaneously. Attempts to raise prices without control of production have lead inevitably to increased production. Price-raising efforts based on governmental purchase and storage of surplus crops seems to offer no permanent support to prices if production is unrestricted. In addition, the pressure of political forces operates against the government's disposing of stored surpluses, since any such move would immediately depress prices. Solution through a tariff on farm products, a procedure which underlay farm legislation in the 1920's, is obviously ineffective as long as we remain primarily an export nation. The single fact which must be faced is that we produce basic farm crops in excess of the amount which the domestic market can purchase at prices high enough to yield the farmers a profit. In a world of nations attempting to be self-sufficient we can no longer rely on disposing of the surplus in the export market. It is becoming increasingly clear that price support without production control cannot be successful. Unless some solution of this problem can be found, there appears to be little reason to expect that the prewar parity between the price the farmer received for what he sold and the price the farmer paid for what he bought will be reestablished.

The Farmer as Businessman.—Under the conditions of specialized production which have come to be common practice in modern farming, the farm must be viewed as an industrial unit and managed accordingly. The farmer must begin to regard himself as a businessman and handle his production problems in a businesslike fashion. It would be trite to say that this has not been true in the past. With some exceptions the farmers have been poor businessmen. They have not understood the importance of the marketing process or their relation to it. They have failed to offer adequately graded products to consumers. They have failed to choose those middlemen best suited to distribute farm products. They have failed to understand the importance of market news and to use it to their best advantage. They have operated as if they were still farming to make a living rather than farming for the market. They have not utilized the waste products and the by-products of farm production as by-products

have been utilized in industry.[1] The many industrial uses for corn give a new market for this agricultural product.

To these difficulties must be added the helplessness of the individual farmer to take action for his own protection. With small producing units, cooperation is necessary to make any action effective. An individual wheatgrower may decide that the price of wheat is low because of the excess of supply over demand and therefore plan to reduce the amount he raises in order to decrease the supply and raise the price. If, at the same time, most of the other farmers raising wheat decide that because of the low price they should raise more wheat so as to maintain their incomes, the excess of supply will increase, not diminish, and the single farmer who reduced his crop will have less to sell at a still lower price. Perhaps the most effective of all the attempts of the Federal government to assist the farmers will prove to be the guidance and assistance granted to them in organizing on a cooperative basis.

[1] An exception may be found in the case of corn, for which a number of industrial uses are being explored. An excellent picture of the varied industrial uses of corn may be found in *Fortune*, September, 1938, p. 54.

CHAPTER IV

HOW RAW MATERIALS MOVE TO MARKET

"Industry is raw material, labor, and capital. Without any one of these three not a wheel would turn, not a man would work, nothing would be produced, there would be nothing to consume."

Characteristics and Uses of Raw Materials.—How does a steel mill get its iron ore? Where does the lumber come from for your new house? What process feeds into American industry the thousands of types of raw materials which keep the factory wheels turning? Where do they come from? What plans guide their distribution? What determines their price? How are they graded with that infinite skill which is demanded by the precision engineering methods of modern industry? How is American industry fed? To understand these problems it is necessary to examine the process of moving raw materials to market.

The conditions which govern the supply of raw materials are in sharp contrast with those which govern the supply of farm products. The supply of both mineral and natural products is fixed and, with the exception of new discoveries and the development of substitute products,[1] cannot be increased. The wide variety of grades and the random variations in quantity which characterize the supply of farm products do not appear in the case of mineral and natural products. Nor are they subject to the effects of the weather, atmospheric conditions, or the ravages of insect pests. They are not scattered broadcast over the entire country but, with a few exceptions such as soft coal, are usually found grouped within small areas where they lend themselves to large-scale ownership, extraction, and processing. We are constantly using up the existing supply, and we cannot replenish it.

[1] Many people spend their lives and much money is used both in exploration and in laboratories to find new sources of raw materials and to develop new products to substitute for older raw materials.

The conditions affecting the demand for raw materials[1] also differ from the conditions which govern the demand for farm products. The users are for the most part industrial concerns.[2] They buy according to exact specifications and their purchases are often made on organized markets. Unlike the demand for farm products, the demand for raw materials is subject to severe fluctuations which follow the business cycle.[3] Especially in the heavy industries, a period of depression enforces a sharp curtailment in the demand for raw materials, while a period of prosperity causes a sharp expansion in the demand. Inasmuch as the prospects for profitable sale of manufactured products made from raw materials guide the level of productive activity, the demand for raw materials is not directly responsive to changes in the prices of raw materials. When a manufacturer sees an opportunity for selling a large quantity of goods at profitable prices, he will not refrain from purchasing necessary raw materials simply because the prices are high. Nor will the same manufacturer be induced to purchase raw materials at low prices if he does not see an opportunity to dispose of the finished products at a profit. Raw-material prices must directly affect the outlook for profits, it is true, but in many industries raw-material costs make up a small percentage of total costs. In these industries a rise in raw-material prices may enter only to a slight extent into the prices of finished goods.[4] The demand for raw materials may generally be regarded as an inelastic demand. It varies, not in response to price changes, but rather in response to the profit outlook of the finished product.

Price Movements.—With large corporations dominating both supply and demand, and with the demand in many cases governed

[1] Frederick, J. H., "Industrial Marketing," Chap. IV, Prentice-Hall, Inc., 1934.

[2] Not all raw materials can always be classified as industrial goods, depending on the use to which they are put. Coal may be considered as an industrial good when used by a factory, but a consumption good when used in a home. Tomatoes are an industrial good for a canning plant, but a consumption good when bought by a housewife.

[3] This extreme variation in demand tends to increase the cost of selling since an unnecessarily large sales organization must be maintained during dull periods in order to be ready for expanding business later.

[4] Variations in raw-cotton prices have little or no effect on the retail prices of men's shirts.

by the sharp fluctuations of the business cycle, the price movements of raw materials are frequently erratic, being determined by forces other than the normal supply-demand relationship. For some raw materials, of which steel is an outstanding example, prices have been maintained almost unchanged through severe business depressions. For others, such as copper and rubber, prices have been sharply reduced in the attempt to stimulate buying. Two forces have been active in reducing the effect of price changes: the inelasticity of the demand for many types of raw materials, such as exists in the industrial demand for copper, and the strong financial position of large manufacturing corporations which operate with a high proportion of fixed costs. The former diminishes the extent to which price cuts stimulate sales or price advances discourage them. The latter serves to minimize the importance of raw-material costs in finished products.

These conditions naturally provide a framework for marketing policy in the great raw-material industries. They explain the stickiness of steel prices, unchanged for long periods and maintained without cut through severe depressions. They explain the prevalence of direct-selling methods and the relatively minor part played by middlemen. They help to explain problems of plant location and the distribution of sales areas, and they illuminate the question of transportation and its relation to the marketing of raw materials. The flow of raw materials into industry presents a fascinating study of the ganglia of the economic system. Diseases which occur in the shape of obstructions to the efficient supply of raw materials may spread and affect every phase of production and distribution.

Concentration of Raw Materials.—The conditions which govern the concentration of raw materials are unlike those which are found in the concentration of farm products. There are not millions of purchasers of raw materials as there are of farm products. Usually there are a few large purchasers. As a result, less need is felt for the wide dissemination of raw materials from central markets. A number of raw materials are sold directly to large users, and many of these users control their own sources of supply.[1] In the case of steel it has been estimated that

[1] This tendency toward integration is seen in steel companies owning their own coal and iron mines, rubber companies developing their own rubber plantations, and paper manufacturers owning timberlands.

over 40 per cent of the total tonnage is shipped to less than 100 companies. Large-scale producers and large-scale users means large individual sales which lessens the need for middlemen, thus facilitating direct sale.

The location of many types of raw materials at a distance from their main consumer markets, however, makes a certain amount of concentration necessary. Contributing to the necessity for concentration is the fact that a number of raw materials which are used together in industry are found in scattered areas. The basic raw materials used in manufacturing steel—iron ore and coal—are not always found together. Assembly is desirable in order to make them available to industry simultaneously. For some raw materials, concentration is necessary in order to assemble the products of a large number of small producers. As in the case of farm products, the concentration of raw materials facilitates grading.

Wherever in the distribution of raw materials conditions similar to those governing the concentration process in agricultural marketing are found, there the concentration process resembles the picture we have traced of small streams flowing together and then being dispersed. This is true to some extent in the marketing of petroleum, of fisheries products, and of similar products. Where both producers and consumers are large, however, the conditions which dictate the formation of that concentration process no longer exist. Grading, processing, and economical storage and transportation are directly available to buyers and sellers at the most efficient scale of operation, and there is little reason to combine the products of individual producers or to transfer to independent agencies the task of marketing in small lots.

Transportation.—Most raw materials run little risk of deterioration or damage in transit, and for many of these products the time consumed in transportation is of relatively little importance. As a result, transportation is not such a vital factor as it is for those farm products which are perishable. Less attention need be devoted to securing speedy movement of merchandise.

Together with labor supply and access to consumer markets, transportation facilities may exercise a very important influence on the location of industrial plants. If the raw material is extremely heavy and bulky and the proportion of waste materials

is large, it may often be convenient to locate near the source of supply plants engaged in processing raw materials or in carrying on further manufacturing operations. The lumber industry offers a good example of this type of location. Under these conditions it is cheaper to transport the finished product to a distant market than to transport the raw material to a distant manufacturing plant. Despite adjustments of this sort, however, for some products, of which coal is an outstanding example, transportation costs may account for half the retail price in markets at a distance from the source of supply.

Manufacturing Requirements.—Modern industry with its precision engineering technique naturally feeds on standardized products which are supplied in exact accordance with specifications.[1] Thus supplied, machines can be operated with a minimum of adjustments. In addition to standardized products modern industry may require a large variety of products, because specialized machines need specialized raw materials. Raw materials, therefore, are frequently assembled from all parts of the world.

The standards for raw materials used in manufacturing may be established in various ways: at times by the buyer of raw materials, at times by trade associations, and at times by the organized exchanges on which they are purchased and sold. Standardization of materials has a direct influence upon marketing costs. With standardized materials purchasers can buy from samples, or from a statement of specified grades, with complete confidence that the materials on delivery will prove to be exactly similar to those offered as samples. There is no need to show the entire stock to a prospective buyer. In this way selling costs are materially reduced. The standardization process also makes it possible to sell easily and conveniently at a long distance and in this way greatly to expand the market for a product. To insure the observance of standards of this character, careful and frequent inspection is necessary. The amount of inspection required, as well as its quality, depends on the extent of the variation from the normal standard which may be permitted. This in turn will depend on the degree of refinement of machine technique in the industry which proposes to use the raw material.

[1] Roorback, G. B., Direct Purchasing of Imported Raw Materials, *Harvard Business Review*, October, 1928, p. 35.

Increasingly, as large-scale industry develops its machine techniques, raw materials and parts used in the manufacturing processes are purchased for individual machines carrying on predetermined operations at predetermined measurements. Purchase on the open market or through middlemen does not always suffice to guarantee a supply of the exact materials required. The manufacturing process might limp along, always subject to the risk of delay because of the failure of supplies of the exact kind demanded.[1] Purchasing tends, under these conditions, to resort to direct contact with sources of supply and to place orders which specify exactly what is needed. Only materials which live up to these specifications in every respect will be accepted. The industrial buyers who control purchasing of this type have a detailed knowledge of all available supply sources and are in a position to check raw materials delivered and to refuse to accept those materials which differ, even slightly, from specification.

Place of the Middleman.—Direct sale is, therefore, much more important in the marketing of raw materials and natural products than in the marketing of farm products. It has been estimated that as much as 65 per cent of all raw materials and natural products are sold directly by the producers to the consumers of raw materials with no intervening middlemen. This method of sale is made possible because of the presence of large-scale buyers and sellers; because of the establishment of standards which are uniformly adhered to; because of the established relations existing between buyers and sellers; and because the companies are soundly financed and do not need the credit assistance of middlemen. It is a desirable method of sale because raw materials or parts are often purchased upon exact specification; because technical knowledge of an advanced nature may be necessary for completing the sale; or because special service and maintenance may be necessary.

The practice of reciprocal buying,[2] which has been growing more common throughout the industrial world, may be another

[1] A manufacturer must assure himself an adequate supply of raw materials, since it is too costly to have his plant running at part capacity or shut down because of failure to get raw materials. Since much of the overhead goes on just the same, it increases his costs and so puts him at a competitive disadvantage.

[2] The advantages and disadvantages of reciprocal buying are set out in

influence leading to direct relations between buyers and sellers. The term "reciprocal buying" is commonly used to describe the practice of linking buying and selling activities between business concerns in such a way that company *B* agrees to purchase from company *A* if company *A* in turn agrees to purchase from company *B*. An oil company may agree to purchase a fleet of trucks from a dealer in automobiles if that dealer in turn agrees to purchase gasoline from the oil company. A railroad may agree to purchase steel rails from a steel company if that company in turn agrees to ship the bulk of its output over the railroad's tracks. Reciprocal buying depends upon direct relations between buyer and seller.

Middlemen continue to function in the marketing of raw materials and natural products as intermediaries for small buyers and sellers. They also serve as sources of supply for large buyers who need quick deliveries to replenish their stocks. Purchasing in this way from middlemen, the buyers are able to operate their businesses with smaller inventories, and so turn over their investment in merchandise more rapidly. Capital which might otherwise be tied up in merchandise inventory is freed for other uses, and the space required for storage and the funds required to carry on storage are reduced. Middlemen in the industrial market provide special grading facilities and are valuable in their function of concentrating supplies from many sources. They also provide a flow of market news with respect to prices, supply and demand, and inventories which may be of great assistance to small purchasers.

Need for Assured Supply of Raw Materials.—Without raw materials industry cannot function. One of the major risks with which industrial managers are concerned is the possible failure of the supply of raw materials. Various methods are used in industry to assure this supply and frequently a company may make use of more than one method of guaranteeing to itself a supply of raw materials of the type and quality desired at the exact time when that supply becomes necessary.

One method of buying is the purchase of sufficient raw materials to fill the immediate needs of the industrial plant. This

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Ralph F. Breyer, "Commodity Marketing," pp. 321–323, McGraw-Hill Book Company, Inc., 1931.

method of purchase is commonly known as "hand-to-mouth buying." Purchasing in this way will enable a plant to operate with a smaller inventory of raw materials, with less space devoted to storage, and with a smaller investment of capital. It also may eliminate the danger of accumulating obsolete raw materials and will minimize the risk of a decline in price. Hand-to-mouth buying increases the expense of purchasing, however, and reduces the possibility of securing quantity discounts. Under certain conditions the risk of not being able to secure an adequate supply of the exact raw materials may become great.

There is a growing tendency in modern business to regard failure to secure supplies when needed as a greater risk than the adverse movement of prices. Many concerns, therefore, are willing to sacrifice speculative activities with respect to price movements in favor of directing all their attention to the securing of raw materials when needed.

Methods of Assuring Supply of Raw Materials.—One method commonly used for insuring the supply is to contract for future delivery of raw materials over a substantial time period. This method is used most frequently when the raw material required is dealt with on an organized exchange. By purchasing in this way, arranging under the contract to receive the supplies over a specified time period, the purchaser may be able to secure the benefits of quantity purchases without incurring the extra costs of maintaining a large inventory. Under contracts of this type the price may be fixed as of the date the contract is drawn, or the price may be set at the market price on the delivery date. Using this method of buying, the purchaser must make a very shrewd estimate of the future activity of the market for that raw material. There is some danger of overbuying by a company which contracts to purchase raw materials and encounters a serious industrial depression with sharp curtailment of sales.

Industrial concerns frequently contract to purchase an entire season's supply in advance. This method of purchase is common when there are no organized markets. It entails serious risks, however, since the movement of prices can make or break the success of this policy. If prices rise following the contract date, the purchaser benefits. If prices fall, he stands to lose. If prices fall far, the loss entailed thereby may far outweigh the potential benefits of having an assured supply of raw materials.

It is a relatively inflexible merchandising policy with the single virtue of guaranteeing a supply of necessary materials.

Another method occasionally employed by industrial concerns to guarantee their supply of raw materials is to own outright the sources of supply.[1] This type of operation is resorted to when the supply of raw materials may be somewhat doubtful, or when there exists the possibility of a monopoly of the supply exercised by competitors. It presents the problem of securing adequate financing, and, at times, problems of disposing of the surplus supply produced by the source in excess of what may be used by the parent concern. This method of controlling the source of supply by outright ownership is frequently used as an instrument of national policy by countries engaged in developing programs of complete self-sufficiency.

The Marketing of Land.—It may be helpful at this point to review briefly the special problems which are encountered in marketing the major classes of raw materials and natural products: land, mineral products, forest products, iron and steel, as well as the marketing of fabricated parts which serve as raw materials for further manufacturing.

Land has a number of special characteristics which directly influence the problems of marketing it. Some of them are obvious. The quantity of land is limited, although certain small additions may be made from time to time through reclamation. Within limits, also, we can say that the quality of land is not subject to change. Its location is fixed. This is the most important characteristic in which it differs from other commodities. The markets for land are local in character. One of the most important features of land is its accessibility to centers of population. Another is the climate which is found in any particular location. Obviously, too, land cannot be transported, and there are no storage problems.[2] The law governing the transfer of property is much more formal and complex than that governing most types of commodities. Hence the legal aspects of marketing land create numerous special problems.[3]

[1] The United States Steel Corp. has several subsidiaries, including the H. C. Frick Coke Company, which supply it with raw materials.

[2] While land is not stored, it frequently is held over a period of time until it can be profitably sold.

[3] Weimer, A. M., and H. Hoyt, "Principles of Urban Real Estate," Chap. XIII, Ronald Press Company, 1939.

There are two major uses for land. One depends upon its fertility, the other upon its location or site. In the marketing of land the important services utilized are selling and financing. The agents who assist in the marketing process usually include brokers, appraisers, title guarantee companies, law firms, and mortgage companies.

With this restricted supply and with the wide variations in demand which exist, the price of land may be subject to tremendous fluctuations, and, from time to time, speculative activities, rather than a true equalization of supply and demand, may determine prices.

Marketing Mineral Products.[1]—As in the case of land, mineral products have a number of special characteristics which exert an immediate and important influence over the marketing procedure. The supply again is limited with the single exception of additions brought about by new discoveries. The products for the most part are nonperishable, and since they are frequently found at great distances from centers of population and production, transportation may be a major problem in bringing them to market. The demand for mineral products, on the other hand, is subject to violent fluctuations which follow the business cycle. The demand, at the same time, is relatively inelastic. In times of major industrial depressions, no conceivable price, however low, may induce the purchase of large quantities of many mineral products. In times of industrial prosperity, a sharp rise in price will not seriously inhibit sales. These conditions exist almost entirely because the cost of procuring mineral products used as raw materials forms only a minor part of the total cost of production of those goods which utilize such raw materials.

Many of the purchasers of mineral products are large industrial concerns. Transportation costs make up an important part of total marketing costs. Production of raw materials of this type is frequently on a large scale. As a result of these conditions, direct sale is the common marketing procedure.

Marketing Fuel Minerals.—The major problem faced in the marketing of fuel materials is the unbalancing of supply and demand.[2] Soft coal, for example, has suffered from this malady

[1] *Minerals Yearbook* gives a statistical picture of this field.

[2] An interesting story of a successful coal company is told in Coal at a Profit: Island Creek, in *Fortune*, March, 1938, p. 87.

since the World War. Other fuels such as oil, electricity, and natural gas have for a variety of reasons usurped a large part of the market formerly served by soft coal. More efficient ways of burning coal have lessened considerably the need for coal.[1] This falling away of demand has in many cases driven the price of soft coal below the cost of production. As in the marketing of mineral products, the problem of marketing fuels centers around transportation costs and the necessity for moving large quantities of fuels for great distances. Integration is a common practice in these industries; and again the purpose is to control transportation and processing in such a way as to minimize transportation costs by locating processing plants near the sources of supply. In the case of petroleum[2] one of the major problems encountered is the control of the supply, since it is not possible readily to limit the amount produced.

There are two different types of marketing channels customarily employed in these industries. One is direct sale by large producers to large consumers. The other employs a variety of middlemen who are used when sales are made to small purchasers to whom it would not be profitable to sell directly.

Marketing Forest Products.—Forest products are marketed under conditions of a large and increasing demand and a decreasing supply. Again, as in the previous case, the demand is subject to tremendous fluctuations depending upon the state of the business cycle; it is subject as well to seasonal fluctuations in the construction industry. Again, too, the demand is relatively inelastic. Under unfavorable business conditions purchase cannot be stimulated at almost any price; under favorable business conditions purchase will be made at almost any price. As in the previous case, transportation and processing are major problems and, to some extent, dictate large-scale operation in order to bring about the most efficient combination of transportation and processing.

Iron Ore and Iron.—The sources of iron ore are generally controlled by the largest users of iron ore, the steel companies. With iron ore an essential raw material for the steel manufactur-

[1] These two factors, it is estimated, have replaced 250 million tons of bituminous coal annually.

[2] Pogue, J. E., "Economics of the Petroleum Industry," pp. 42–48, The Chase National Bank, 1939.

ing process and with no possible substitute available, the steel companies have gone to great lengths to assure themselves of a continuity of supply. In many cases they have resorted to outright purchase of lands containing iron ore. The demand for iron is subject to those fluctuations which depend upon business conditions,[1] but over a long period of years it has been growing steadily. The supply is being depleted, but, with existing deposits, the danger of exhaustion is still far in the future. Marketing problems are almost entirely within individual companies, and the greater part of purchase and sale is made direct without wholesale intermediaries.

Steel.[2]—The conception of raw materials should not be limited to the types of products we have been discussing so far. Manufactured and semimanufactured goods may also serve as raw materials for further industrial processing. Steel may be sold as a raw material to automobile manufacturing concerns. Manufactured parts may also be sold as raw materials for further production. In the marketing of goods of this type, wholesalers and other types of middlemen play an active part. Again, however, as in the previous examples, when both seller and buyer are large industrial concerns, the sale is usually made direct without any intermediaries.

Perhaps, more than any other type of raw material, steel products have been subject to semimonopolistic control of prices. This condition is, of course, favored by the inelastic demand which we have seen is the characteristic demand for goods flowing into heavy industry. Until very recently an unusual pricing system has been employed in the steel industry, which contributed to the stickiness of prices. This pricing system has become widely known as the "basing-point" or "Pittsburgh-plus" system. This method of pricing provided essentially that, regardless of the locations of either steel plant or customers, the price to the customer should be the mill price plus transportation costs from Pittsburgh to the customer's plant. A customer located in the

[1] "The yearly demand for iron ore has fluctuated widely. It corresponds quite closely to the fluctuations in general business conditions. This is to be expected in view of the widespread use of iron and steel products, from which the demand for ore is derived."—BREYER, *op. cit.*, p. 143.

[2] *Ibid.*, Chap. X, Marketing Rolled Steel, gives a longer discussion of the marketing of steel.

Chicago area and purchasing steel from a plant in the same area had to pay a price which included transportation charges from Pittsburgh.

The Pittsburgh-plus system was subjected to severe attack during the 1920's and has since been replaced by a system of prices which includes a number of basing points. More recently, the attacks have shifted to the rigidity of steel prices, the critics arguing that greater flexibility and more ready adjustments to business conditions would stimulate buying in dull times and diminish the extent of the fluctuations of the business cycle.[1]

Fabricated parts, like raw materials, are usually sold on specification and are marketed without the intervention of middlemen. The sole exception to this general rule occurs in the case of standardized parts supplied to a variety of industries. Here, particularly when individual purchasers are small, various types of wholesalers, manufacturers' agents, and supply houses serve to carry inventories of supplies and sell on a hand-to-mouth basis to industrial plants.

Summary.—Throughout the marketing of raw materials a basic pattern of distribution can be found. Direct sale is the common practice when both buyer and seller are large or when raw materials are supplied in accordance with predetermined specifications. Middlemen are found in the marketing process principally when sale is made to numerous small purchasers or when the raw materials are completely standardized. Going directly into heavy industry, raw materials serve a relatively inelastic demand and one that fluctuates in response to the movements of the business cycle. Control of supply and the necessity of dovetailing transportation and processing activities in the most economical way often lead to large-scale ownership and the integration of ownership of raw material sources and processing plants.

[1] An excellent discussion of present methods of pricing steel is found in What is a Steel Price? in *Fortune*, October, 1938, p. 41.

CHAPTER V

WHOLESALERS OF MANUFACTURED GOODS

"I should like to point out that the services of the wholesalers can be dispensed with. It is a mistake to call them services. They will not carry adequate stocks. They will not promote merchandise as it should be promoted. They will not advertise. They will not work with retailers to advance the sale of manufacturers' goods. Their salesmen do not sell; they merely take orders. It is obvious why their position in distribution has been declining in importance and why they are doomed to become extinct."

Characteristics of Manufactured Goods.—During the past 10 years the position of the wholesaler in the marketing process has been the center of very active debate. The quotation at the head of this chapter is typical of the complaints of many manufacturers who have become dissatisfied with the services of wholesalers in distributing their merchandise. Many manufacturers have changed their methods of distribution and have undertaken to sell direct to retailers through their own branches. Yet a marketing institution which has existed from the earliest days of distribution[1] cannot be so incapable of performing useful distributive functions that we suddenly discover that it should be retired from business.

As background for our study of the activities and the services of wholesalers it may be well to sketch the characteristics of the merchandise they handle, for here, as elsewhere in marketing, distribution methods are determined by three variables: merchandise, buyers, and sellers. Their characteristics and habits help to provide the framework of distribution and almost inevitably dictate the manner of sale for all types of goods.

Manufactured goods are commonly produced under large-scale production methods. A large market is needed in order to sell the products of a tremendous factory, and, with the necessity for securing a large market and the need for operating continu-

[1] Beckman, T. N., and N. H. Engle, "Wholesaling," Ronald Press Company, 1937. Chapters III and IV discuss the history of wholesaling both abroad and in this country.

ously in order to take advantage of machine production, problems of distribution become of major importance. Factories frequently have surplus productive capacity, and their operators are greatly concerned with securing a larger control over their sales territories and with creating or stimulating an increased demand. With manufactured goods of this type the producer has absolute control of both the quality and the quantity of the merchandise produced, and, with such uniform merchandise, sales can be made by sample. Control over production with respect to the quality and uniformity of merchandise makes it possible to brand and advertise manufactured goods.

These qualities of manufactured goods, then, are dominating in their influence upon marketing: their uniformity, the possibility of selling from samples, and the importance of brand. In connection with this last quality it is important to notice that the use of brands or trade-marks increases the manufacturer's interest in his control over his own products, inasmuch as his name is attached to them. From this, too, may stem his interest in methods of sale used by both wholesalers and retailers, in price, in the statements made by salesmen to consumers, in the types of retail outlets selected by his wholesalers, in the credit terms which are extended to consumers, and in the services and repair facilities which are offered to the final purchasers.

Certain other characteristics of manufactured goods have some significance for their marketing patterns. They have, of course, no problem of seasonal production, and most types of manufactured goods can be stored with safety. Frequently, however, there is a hazard, not because of any deterioration in the merchandise which may occur as a result of lapse of time, but because of the obsolescence that follows upon style change.

Types of Manufactured Goods.—There are a number of possible classifications of those manufactured goods which are handled by wholesalers. They are useful not for their names, but because classification in this way is significant of the influence of different types of merchandise on marketing methods. One type may be marketed in one way, another type in another way.

Two classifications which are almost universally used are consumers goods and industrial goods. Consumers goods are goods sold to the ultimate consumer who uses them directly and does not carry on any further productive process. To illustrate

this type of merchandise, simply think of all the products you buy in the course of carrying on your daily existence: food, clothing, and shelter. Industrial goods are goods sold to industry where they are used to further the productive process: factories, machines, supplies, and equipment[1] are characteristic of this type of merchandise.

There are a number of other classifications of goods which may be helpful in guiding thinking about marketing methods. One of these is the division of all merchandise into durable and nondurable goods. Businessmen generally think of nondurable goods as those which we consume within the space of one year, and of durable goods as those which may last from a year to a lifetime. Automobiles, houses, refrigerators, and radios are typically listed as durable goods.

One class of merchandise is frequently spoken of by businessmen as semimanufactured products, goods which need further processing before they are ready for sale to consumers. In this respect semimanufactured goods may also be thought of as raw materials for those factories which purchase them. Equipment and supplies for industry are sometimes set aside as a separate classification of merchandise.

One other classification may be mentioned at this point. This is the division of consumers goods into convenience goods, shopping goods, and specialty goods. This classification really affects the relation between the retail store and the consumer, but it is of significance to the manufacturer because it may help to determine the type of retail distribution which he will seek to secure, and so may affect his relations with and the use he makes of wholesalers.

Channels of Distribution.—Despite the decline in the importance of the wholesaler in recent years, wholesalers continue to handle the bulk of the merchandise produced and distributed in the United States, and businessmen still regard as the "normal" channel of distribution the manufacturer to wholesaler to retailer to consumer line.[2] Consumers goods are bought almost entirely

[1] Lester, Bernard, Changing Methods in the Marketing of Industrial Equipment, *The American Marketing Journal*, July, 1936, p. 46.

[2] A good discussion of the confused channels of distribution is found in Corwin D. Edwards, The Struggle for the Control of Distribution, *The Journal of Marketing*, January, 1937, p. 212.

through retail stores. Manufacturers may sell to retail stores in a variety of ways. They may sell direct through their own salesmen. They may sell to wholesalers who in turn sell to retailers. They may sell to wholesalers who then sell to other types of wholesalers who in turn sell to retailers. Some manufacturers will at one time use several different methods of sale because of their desire to reach a number of markets, or because of the different conditions which prevail in different markets.

When a manufacturer wishes to have almost universal distribution, *i.e.*, when he wishes his merchandise to be sold in practically all retail stores of a given type, he is likely to sell through wholesalers. He does this because it would be very expensive for him to employ a salesman to sell a single article or a narrow line of products. The cost of maintaining that salesman, in comparison with the amount of merchandise he could sell, would be very high. One exception to this line of reasoning is found in the distribution of merchandise at high unit prices. The wholesaler, however, employs salesmen who contact all stores of a given type and sell a great many products. Under these conditions the cost of selling a single product is small because the expense of maintaining each salesman is allocated to the hundreds of products which he may have to sell. A manufacturer may also decide to sell through wholesalers if he wishes to reach retailers widely scattered over a large territory. Here, again, the time consumed by the manufacturer's own salesmen in traveling between retail outlets would result in the incurring of very high sales costs, and again the costs are reduced for the wholesaler's salesmen who sell hundreds of products and make each order a large one. A distribution policy which illustrates an adaptation to market conditions is exemplified in the decision of a manufacturer to sell direct to large purchasers and to turn small accounts over to wholesalers.

Direct Selling.—When a manufacturer produces a wide line of products which are sold in the same outlets, he may decide to sell direct to those outlets without using wholesalers. Where his salesmen resemble a wholesaler's salesmen, in that they have a number of products to sell, sales costs are distributed over a wide line and add only slightly to the cost of marketing any one product. The manufacturer may also decide to sell direct to retailers if his product is large and expensive. In this case the

cost of selling is offset by the high unit sale. Manufacturers of perishable food products frequently sell direct but usually do so only when their salesmen can sell a number of products to the same outlets. This method of sale is employed because of the perishability of certain food products and the manufacturer's unwillingness to entrust to the wholesaler his reputation of selling only fresh goods. Occasionally, when a product requires an unusual amount of service or repair work, the manufacturer will sell direct to the retailer because of his unwillingness to entrust to wholesalers that repair work which, if poorly performed, may endanger the reputation of his product.

Selecting a Channel of Distribution.—Comparative costs are an important influence in the selection of a channel of distribution.[1] In general, the manufacturer of one product or of a few products that fall into the convenience-goods classification and are sold at low prices in numerous retail stores finds that the wholesale channel offers low-cost distribution. The manufacturer of higher priced shopping or specialty goods often finds it cheaper to sell direct to his retail customers, and he may select this method of distribution to secure other advantages as well. The manufacturer of a wide line of inexpensive convenience goods may find it cheaper to sell direct.

Channels of distribution are not always determined on a comparative-cost basis, however. The desirability of controlling quality or the selection of retail outlets may force a manufacturer to sell to retail stores through his own sales force even when conditions are such that distribution through wholesalers can be effected at less expense. Occasionally, when this situation arises, a compromise solution is reached whereby the manufacturer sells to exclusive wholesalers.[2] The agreement to grant to one wholesaler sole rights to distribute a manufacturer's products within a specified territory usually carries with it a greater degree of control by the manufacturer over the wholesaler's selling practices. Under exclusive agency agreements, the manufacturer may be able to share in the selection of retail outlets

[1] Much information on the costs of wholesaling can be found in U.S. Department of Commerce, Bureau of the Census, Census of American Business, Wholesale Distribution, Vol. VI, 1937.

[2] Weiss, E. B., and C. B. Larrabee, "How to Sell through Wholesalers," Chap. V, Harper & Brothers, 1937.

and so control, through the wholesaler, the freshness of retail stocks. Exclusive wholesale arrangements are often encountered even in the marketing of specialty goods.

Problems arising in connection with the distribution of merchandise in which style plays an important part, as well as merchandise which requires extensive or carefully supervised installation and repair service, frequently influence the selection of channels of distribution. Comparative costs of distribution through various channels must be regarded as a major influence in the determination of marketing methods. But comparative costs alone will not explain the scheme of modern marketing. The factors just mentioned, quality and service, control the necessity of speedy distribution of style goods and of supervising installation and service; all influence the selection of channels of distribution. Distribution through high-cost channels may be forced upon a manufacturer because of the importance of one or several of these influences for his particular type of merchandise.

Consumers Goods—Wholesale Markets.—The central wholesale markets for manufactured goods perform somewhat different functions than do the central wholesale markets for farm products. Manufactured goods are generally uniform in quality. Their distribution begins from large factories. Each producer's output marketed under his brand tends to be in the nature of a semimonopoly product, in that it differs, however slightly, from the products of other manufacturers. There is no need to assemble merchandise from a number of small producers. For all these reasons the process of concentration preceding distribution is not required for most types of manufactured products sold to ultimate consumers, and the large wholesale markets serve primarily, not as concentration centers, but rather as distribution centers.

The major function of wholesale markets for manufactured goods, therefore, may well be stated as that of easing the task of distribution. Many manufacturers of similar products will gather in the same city where adequate financing facilities and suitable labor supply are available. The location of the major wholesale markets for these manufactured goods is determined also by their relation to large groups of customers, and by the presence of adequate transportation facilities. There are a number of major wholesale centers located throughout the

United States, each one serving a surrounding subsidiary territory. Some are very large cities and serve large subsidiary territories, others are small and serve small territories; but in each case the characteristic features of a city serving as a central wholesale market are that it supplies the retail stores in the surrounding territories, that it is a financial center, and that transportation lines flow from it into the surrounding area.

There may be a grouping by wholesale trades within each city. To ease the task of buyers inspecting the offerings of various wholesalers and manufacturers, sellers frequently locate their salesrooms within a few blocks of each other; thus there have grown up in many of our large cities distinct areas given over to the practice of a variety of different types of wholesale business. The wholesale produce sections in many leading cities and the garment district in New York are examples of this type of product grouping.

The Wholesaler of Consumption Goods.—The word "jobber" is frequently used to denote a wholesaler. Until recently there was some distinction in meaning between the two words. Usually "jobber" was reserved to apply to a wholesaler who sold direct to retail stores, while the word wholesaler was used to apply to a businessman who sold to jobbers. At the present time, common use of the two words has made them more or less synonymous; the term wholesaler will be used here to apply to any businessman engaged in distribution, buying from manufacturers and other producers and selling the merchandise he handles to retail stores or to other wholesalers.[1]

Services of the Wholesaler to Retailer.—The major functions performed by wholesalers[2] include the following: assembling merchandise from many manufacturers, dividing that merchandise into small lots for resale to retail stores, carrying adequate inventories to supply retailers, financing retailers through the extension of credit, and making delivery of merchandise to retailers. The following may also be listed as subsidiary func-

[1] "A merchant middleman who sells to other middlemen and/or to industrial and commercial users but who does not sell in significant amounts to ultimate consumers."—Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

[2] Beckman and Engle, *op. cit.*, Chap. VIII, discusses these functions at some length.

tions: furnishing advice and counsel to retailers, supplying market news, and disseminating style information. As we shall see, not all wholesalers perform all these functions, and if any one function must be singled out as the dominant characteristic of wholesalers, it should be that of buying in large lots from manufacturers and selling in small lots to retailers.

If a small retailer should attempt to purchase direct from manufacturers in the quantities which he could sell to his customers, he would soon find the expense of buying in this way to be much greater than the expense of buying through a wholesaler. He would find that manufacturers would be compelled to charge him higher prices because their selling expense would be substantially increased.[1] The cost of transporting merchandise would be greater when a number of small shipments had to be made, and many other expenses would increase in proportion. Only the large independent retailers and chain outlets in the grocery and drug fields, therefore, find it profitable to buy a large per cent of their merchandise direct from manufacturers. Manufacturers, in turn, find it profitable to sell merchandise direct only to outlets which purchase in large quantities. This practice is not uniform in all types of stores, however. Independent clothing and shoe stores frequently buy direct from manufacturers. They purchase in larger quantities, and the risk of style change makes it desirable to shorten the time consumed in distribution.

The importance of the assembly function performed by the wholesaler may be gauged from the fact that many wholesalers carry in their regular stocks from 10,000 to 30,000 different items of merchandise. A grocery wholesaler normally carries in stock all the merchandise which any of the stores he services may sell. This means that his typical stock is much larger than the inventory of any single retail grocery store. By purchasing this large variety of merchandise in bulk, the wholesaler is able to secure quantity discounts and other concessions from manufacturers. In this way the cost of assembly is materially less than it would be for any individual retailer attempting to maintain contacts with all the manufacturers who produce the mer-

[1] Even the wholesaler is finding that some retailers place orders which are too small to be worth while. Thus he has both "profitable" and "unprofitable" customers.

chandise he sells. The reserve maintained by a wholesaler is much less than the combined reserves of his retail customers would be if they bought direct from manufacturers.

The next task of the wholesaler following the purchase of his inventory is the division of the merchandise into the sizes, qualities, and varieties demanded by retailers. He may buy in large quantities, but he must sell in small quantities, and this process frequently requires the breaking up of packages and cases in order to meet the needs of his retail customers. Manufacturers, of course, find it more convenient to ship in large quantities because of the lower unit transportation costs, lower selling costs, and savings in handling and in office costs. In their attempt to carry on business with small stocks of merchandise and a high rate of turnover,[1] retailers must purchase in small quantities and reorder frequently,[2] sometimes in units of fractions of 1 dozen. All these characteristics of the distribution process serve to underline the important part played by the wholesaler of any type of manufactured product. The wholesaler has still another function. He extends credit to his numerous retail customers. He is in a better position to extend credit than is the manufacturer. He knows his customers better, he is in closer touch with them, and he has more information upon which to base his extension of credit. His office is equipped to handle a great many small accounts. The manufacturer who attempts to sell direct to retailers often is prevented by distance from securing that intimate knowledge of the affairs of small retail businesses which is necessary for the wise control of credit. Nor would the manufacturer be able to rely exclusively on the reports of the commercial credit agencies because he would find that a great many of his retail customers were so small and their credit standing so poor that on the basis of commercial reports he would have either no information or only such information as would lead him to deny the extension of credit. Very few retailers have sufficient capital

[1] The number of times annually the merchandise inventory is replenished and sold. Turnover or "stock-turn" may be computed by dividing sales by average inventory.

[2] For several years the retailer has been trying to increase his rate of turnover by cutting down the size of his inventory. This tends to shift the burden of storage to the wholesaler. One writer has said that, since the retail store is a place to *sell*, then storage must be performed elsewhere.

to enable them to carry on their businesses without credit, however, and so again the wholesaler performs a very valuable service in distribution, offering a service which few manufacturers are in a position to extend as satisfactorily. In the past the wholesaler has been inclined to be too liberal with his credit, with disastrous results both to himself and the retailers involved. A wise credit policy on the part of the wholesaler would work to the advantage of both himself and his retail customers.

Many retailers also rely upon their regular wholesale supply houses for advice and market news. The wholesaler,[1] through his contacts with many other retail stores, is in a position to report on the quantities, qualities, and styles of merchandise which are being sold in other stores. He is in close touch with the manufacturing markets, he knows price trends, and he has advance information on the new offerings of manufacturers. A number of wholesalers make a practice of advising their customers on almost every phase of store management. They assist in the selection and arrangement of inventories. They aid in preparing advertising and making sales plans, and they have been active in securing the adoption of uniform accounting systems. Many of these services have been developed by wholesalers in recent years because they have realized that their existence depends upon the success of the small independent retailer who needs help to strengthen his competitive position against the chain outlets. A number of wholesalers have gone one step further and have organized their retail customers into voluntary chains. In chains of this type the retail stores are independently owned, but central control and planning is offered to the stores by the wholesaler serving as the directing unit for the voluntary chain.

The Wholesaler's Services to the Manufacturer.—To appreciate the nature of the manufacturers' complaints about wholesalers, it is important to understand the relationship between them. We have already discussed the relation of wholesaler and retailer; that which exists between wholesaler and manufacturer is somewhat different.

[1] Both wholesalers and manufacturers do educational work with retailers. Since the manufacturer has a comparatively narrow line of goods, his educational program is inclined to place emphasis on these goods. The wholesaler, who has a much more varied line, is less likely to have a biased program unless he, like the manufacturer, is pushing his private brands.

The wholesaler offers the manufacturer an established channel of distribution. He has a selling organization prepared to market the manufacturer's product. He has retail customers who regularly purchase from him, and he knows the possibilities of the entire market which he serves. It would cost the manufacturer a great deal if he attempted to build a duplicate organization to sell his product. Although the manufacturer in this position would be well aware that it would cost him a substantial amount to build such an organization, he would not be able accurately to predetermine the exact cost of marketing through his own organization, whereas he knows exactly the margin he must grant the wholesaler who agrees to carry and sell his merchandise. The rock upon which the wholesaler's economy of operation is founded is this: that he spreads his cost of operation over a great many items so that the unit cost of storage or of finance or of selling is very low. The typical manufacturer selling one or two products must let the entire cost of his marketing division fall directly upon these few products. The cost per unit sold is very high. The wholesaler's services, therefore, are particularly important in selling to small retailers and to retailers scattered over a large territory.

The major criticisms made by manufacturers[1] are that wholesalers do not sell merchandise but merely take orders, that they carry inadequate stocks, that they refuse to introduce new merchandise, and that they pay little attention to working with retailers in the development of selling aids for retail stores.

In reply to these criticisms, it should be said that for the most part the facts upon which they are based are true. Wholesalers do not make aggressive selling agents. They do not introduce new products well. Their salesmen are frequently little more than order takers. But, given the conditions under which they must operate, they could not perform many of these services to the satisfaction of manufacturers and earn a profit. Rightly used, wholesalers can be valuable aids in the distribution process, but it should be kept in mind that the margins allowed them for covering expenses and profits are small, and if they wish to remain in business they cannot undertake the services which some manufacturers would like to have them perform.

[1] Weiss and Larrabee, *op. cit.*, Chap. I.

Many manufacturers who understand the true function of wholesalers use them solely for the regular service of small retail stores. When these manufacturers have new products to introduce, they send out missionary salesmen[1] who make calls directly upon retailers and sell the new products, placing the orders with the retailers' regular wholesalers.[2] Manufacturers often maintain special promotional sales forces which regularly call upon retail stores and assist retailers in planning displays of the manufacturers' merchandise. When manufacturers wish wholesalers to make extra efforts in selling their products, they attempt to interest them by special offers, extra margin, free deals, or by the grant of exclusive selling rights in these territories.[3]

Manufacturers operate in this way because they realize the high expense which is attached to direct sale, except when the manufacturer has a very wide line of merchandise, when he is selling to a highly concentrated market, when the unit price of his product is very high, when the nature of the merchandise requires special safeguards for its quality, or when the services offered with the merchandise are such that the manufacturer is unwilling to entrust them to a wholesaler.

Eliminating the Wholesaler.—We have already discussed some of the conditions which bring about direct selling by manufacturers to retail stores. Many of them are worth examining in greater detail. The basic reason for a manufacturer's attempting to sell direct to retail stores is the desire to secure greater control over the sale of his product. This control can be maintained only if the manufacturer himself sells to the retail stores. If he sells through a wholesaler, he loses contact with his merchandise at the moment when title to it passes out of his hands. The ultimate selection of a method of distribution will depend, therefore, upon the degree of control which the manufac-

[1] "A salesman employed by a manufacturer or wholesaler to contact the customers of the middlemen who distribute his product or products. This contact is usually for the purpose of developing good-will, creating demand, but sometimes with the aim of taking orders for delivery by such distributing middlemen."—Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

[2] Weiss and Larrabee, *op. cit.*, Chap. XIV, presents a discussion of the disadvantages of missionary salesmen.

[3] The exclusive selling agencies are not common in the grocery field. They are more often found in the dry-goods field.

turer wishes to exercise over the sale of his product, together with the comparative cost of selling through different channels. Other considerations which may contribute to the decision are the financial resources of retailers and manufacturers, the character of the product itself, and those trade customs which have been established over a period of years.

It is important to realize that here, as elsewhere in distribution, a change in the agencies performing the marketing functions does not eliminate a single function. If the manufacturer elects to sell direct to retailers, he must himself perform every one of the functions which would otherwise be performed by the wholesaler: he must extend credit to retailers, he must carry adequate stocks, he must make deliveries in small quantities, he must send his salesmen to call on retailers, he must provide such merchandising aid as the wholesaler usually offers, he must carry out every one of the activities which are normally performed by wholesalers. Unless he is selling a wide line of products, or products which have high unit prices, there is an excellent chance that he will find this cost of distribution rising under conditions of direct sale. He may still choose to sell direct, even with higher costs, if direct sale is necessary for the essential control required by that type of merchandise, or in order to prevent loss or the alienation of consumers. Under these conditions, however, he will consciously sacrifice profit for that control of the distribution process which he believes necessary for the successful continued sale of his product.

Types of Wholesalers.—There are a number of different classifications of wholesalers which are commonly used. Wholesalers may be classified by the types of products which they sell, as grocery wholesalers or hardware wholesalers; by the volume of their business; by the extent of the line handled, as general wholesalers and specialty wholesalers;[1] by the size of the territory in which they operate,[2] as national wholesalers, sectional wholesalers, and local wholesalers; and by the types of services which they offer, as full-service wholesalers and limited-service wholesalers.

[1] The general wholesaler in the dry-goods field carries a full line of dry goods. The specialty wholesaler in that field specializes on a portion of the line carrying only piece goods, for instance.

[2] Beckman and Engle, *op. cit.*, pp. 209–216.

In recent years there has been a pronounced trend away from that type of wholesaler who sold throughout the entire country, the national wholesaler. One of the outstanding examples of this type of wholesaler was Marshall Field & Co., which recently discontinued its wholesale business. Executives of the company, in explaining the action, stated that the function of the national wholesaler was rapidly declining and that the firm was doing little more than filling small orders for a scattered group of small retail stores. They estimated that during the previous 15 years there had been a decline of 44 per cent in the volume of purchases from wholesalers.

At the present time the interest of retailers is in getting quick deliveries of small orders from wholesalers. The type of wholesaler best prepared to offer this kind of service to retailers is the local wholesaler[1] who serves the small area around his warehouse. Wholesalers of this type are widely used by manufacturers of nationally advertised merchandise. They have low costs of operation, and they are in close touch with customers in their own territory. They are in a position to offer quick delivery service and so to assist their retail customers in carrying on business with very small stocks of merchandise.

The greatest amount of wholesale business is handled by local-service wholesalers who perform most or all of the functions normally reserved for wholesalers. A number of merchants in this classification have opened separate departments on a reduced service basis to compete with the lower cost wholesalers who sell on a cash-and-carry basis.

Special Types of Wholesalers.—There are many types of local wholesalers who can be conveniently classified by the services which they offer. There are drop shippers who operate without warehouse stocks and, therefore, at low costs of operation. Wholesalers of this type take orders from retailers and place these orders with manufacturers who ship direct to retailers.[2] Shipping merchandise in small lots to retailers, of course, somewhat increases the expense of distribution for the manufacturers.

[1] The local wholesaler is the most important type, numerically. He, also, is of increasing importance in the total volume of sales.

[2] Every wholesaler makes drop shipments occasionally. The term "drop shipper" is applied to those wholesalers who do most of their business in this way.

Another type of wholesaler is the cash-and-carry wholesaler. This type of merchant carries goods in stock for sale on a cash basis. Retailers who purchase from him call for their own merchandise. Distribution costs are substantially lower for wholesalers of this type, and they are frequently found in the distribution of such products as confectionery, soft drinks, and fresh fruits and vegetables. Through patronizing cash-and-carry wholesalers, retailers may purchase for less and so place themselves in a better position to meet the competition of chain stores. The cash-and-carry wholesaler has seldom irritated the manufacturers of advertised brands by pushing his own private brands. Neither the drop shipper nor the cash-and-carry wholesaler eliminates any of the functions of the wholesaler. They simply shift these functions to others. For instance, the drop shipper shifts the storage function to the manufacturer while the cash-and-carry wholesaler shifts the delivery function to the retailer.

Another specialized type of local wholesaler is the wagon jobber.[1] This type of wholesaler usually carries only a few products and makes frequent calls on retailers. He operates his own trucks and sells to retail stores from his trucks, making deliveries and collections as he sells. His costs of distribution are rather high, but wholesalers of this type have been popular in the distribution of semiperishable food products which deteriorate with storage. He enables the small retailer to keep fresh stock on his shelves and to buy in small quantities frequently, thus speeding up his rate of turnover.

A small amount of merchandise is sold through catalogue wholesalers.[2] As the name implies, catalogue wholesalers solicit the major part of their business by mail. Since this is a rather inactive method of sales promotion compared with the use of salesmen by other types of wholesalers, they have not been very successful and sales have been confined generally to country dealers and to very small merchants. Their costs of operation have been high, which accounts, in part, for their declining importance.

[1] McFadden, R. W., A New Step in Food Wholesaling, *The Nation's Business*, January, 1933.

[2] Butler Brothers is an example of the catalogue wholesaler. Their catalogue "Our Drummer" for over 50 years served as the buying guide for many small-town merchants.

Industrial Goods.[1]—The importance of direct-selling methods in the marketing of industrial merchandise has already been discussed.[2] Wholesalers find a place in the distribution of industrial goods usually when products are in general demand and when they are standardized. They are commonly used to distribute supplies which may have a market in almost every factory. In general, the same conditions govern the use of wholesalers for industrial goods which apply to wholesalers dealing in consumers goods. They are used when they sell to many purchasers, when the average unit of sale is small, when the merchandise dealt in is standardized, when the individual buyer has a doubtful credit standing, or when the product handled does not need aggressive selling.

There are in the industrial-goods classifications a number of broad types of wholesalers. There are mill supply firms which tend to specialize in the sale of a relatively limited line of merchandise which finds a market in the area adjacent to the supply house. They sell to industrial consumers and offer such typical wholesale services as storage space, delivery, salesmen, and the maintenance of sufficient inventory to satisfy most of the needs of their customers. They assume credit risks for the manufacturer and are prepared to meet the immediate needs of their customers for supplies and equipment. As in the use of wholesalers of consumers goods, purchasers who deal with mill supply houses secure quick deliveries and are able to operate with smaller stocks. They have access to market news; they purchase in small quantities; and they are certain of being supplied with adequate services and repairs.

There are also a large number of specialized merchants engaged in the wholesaling of industrial goods. Some of these handle only a single type of merchandise, such as the wholesalers of chemicals or steel. There are others who handle several lines of merchandise which are related because they are sold to the same industry, *e.g.*, the distributors of railroad equipment and supplies. There are others who may handle a great number of items, which, however, are closely related and which may be

[1] Beckman and Engle, *op. cit.*, Chap. X.

Elder, R. F., "Fundamentals of Industrial Marketing," McGraw-Hill Book Company, Inc., 1935.

[2] See Chap. VII of this text.

sold to a number of industries, as the wholesalers of electrical supplies.

Functional Middlemen.—Other types of middlemen are active in the wholesaling of manufactured goods. They are occasionally called "functional middlemen." They operate in and assist the distributive process without taking title to merchandise, and this point constitutes their chief difference from the types of wholesalers described above who, in general, assume the risks of ownership. There are selling agents, manufacturers' agents, and brokers. There are middlemen who represent buyers, sometimes known as "resident buyers." There are agencies, such as the advertising concerns, which contribute to the marketing process and which, perhaps, can best be classified in this miscellaneous group of functional middlemen who do not take title to merchandise. All these types of middlemen perform valuable services. Their functions are an integral part of the marketing process, and we know that without them their functions would have to be taken over by either the manufacturer or the retailer; they could not be totally eliminated.

Selling agents,[1] one of the important types described above, are very active in the textile trade and canning industry. They offer financial assistance to the mills whose products they sell and may occasionally extend their control and guidance to problems of production. In the textile trade they frequently render the mills fashion information and keep them abreast of other market news. They are commonly paid on a commission basis and usually have exclusive selling rights for the products of their principals. They handle the output of a number of noncompeting manufacturers who are producing articles of the same general line. In recent years there has been a pronounced tendency toward integration in the marketing of textile products. As a result of this movement, selling agents have frequently become the selling departments of integrated producing and marketing corporations.

Manufacturers' agents represent an intermediate stage between the independent selling agent and the controlled selling department of a manufacturer. They usually are financed and controlled by the manufacturers whom they represent. They, too, handle related lines of merchandise, but merchandise which is

[1] Also spoken of as "selling houses."

noncompeting. Usually they have exclusive selling rights in a limited territory, and their authority over prices and terms of sale is limited by the agency contract. Manufacturers frequently turn to this method of selling when their line of products is somewhat too narrow to stand the expense of direct sale. The manufacturers' agent, by spreading his costs over a wider line of merchandise, is able to reduce the selling costs allocated to each unit. Both the selling agent and the manufacturers' agent represent the producer or manufacturer.

Brokers are frequently found in the distribution of manufactured products. They usually specialize in a particular type of product and are very important in the sale of food products. Brokers are frequently used in industries where the producers are small and widely scattered. Located in the leading markets, they maintain continuous direct contact with large purchasers and for a relatively small commission are successful in placing the production of a large number of small factories. Brokers may be found to represent either buyers or sellers or both. They are primarily go-betweens with little power over prices and terms of sale.

Resident buyers[1] commonly represent buyers rather than sellers and are frequently employed by retail stores for the purpose of maintaining continuous contact with manufacturers and wholesalers in the leading markets for department-store merchandise.[2] They provide for their member stores a continuous flow of information with regard to styles and prices, assist buyers when they are in the market, make in-between purchases upon order from the member stores, and follow up deliveries. In some cases they combine orders of retailers to get better purchase prices. They are divided into two types: those who operate on commissions and those who are known as "paid" buyers supported by annual fees from the member stores.

The last specialized type of middleman to be mentioned is the advertising agency. Beginning as the representative of the publishers, the advertising agencies have become purveyors of ser-

[1] In the hardware trade such buyers are called "purchasing agents."

[2] Almost all department stores with sales of $500,000 or more are represented on the New York market by resident buyers. The very largest department stores frequently dispense with the services of a resident buyer and maintain their own buying offices in New York.

vice for companies which wish to advertise. Their activities have extended in recent years to the provision of merchandising advice, to the supervision of market research, to the preparing of copy and layout, and to the checking of results in terms of sales.

Wholesaler Sponsorship of Private Brands.[1]—The growth of the practice of private branding is directly connected with the relation of wholesalers to manufacturers and wholesalers to retailers. The ownership of a brand name carries with it extensive control over marketing policy. The common situation in distribution, with brand names owned by manufacturers, left wholesalers in the position of buying and selling merchandise under conditions of limited authority. To strengthen their positions and in part to increase their profits, a number of wholesalers in different trades have developed private-brand merchandise.

They contract with manufacturers to produce this merchandise, but the brand names under which the merchandise is offered to retailers and consumers are owned by the wholesalers. They dictate distribution policies, and they retain the power to change manufacturers or to vary product, design, or package.

This practice has been an added irritant to manufacturers in their dealings with wholesalers. They complain that wholesalers instruct their salesmen to sell private-brand merchandise first and manufacturers' brands second. One frequently encounters the statement that the distribution of manufacturers' brands is sabotaged by wholesalers intent on increasing the sale of merchandise under their private-brand labels.

In defense of the wholesalers it should be pointed out that their own business lives have frequently been jeopardized by manufacturers who have retained the right to sell direct to the most profitable accounts, leaving to wholesalers the smaller and less attractive customers. Wholesalers have, from time to time, lost the opportunity to profit from the sale of popular merchandise when manufacturers have rearranged distribution policies, changing from indirect to direct sale. They have often been

[1] "Commonly and loosely used to designate a middleman's brand as distinguished from a manufacturer's or producer's brand."—Report of the Committee on Definitions, The National Association of Teachers of Marketing and Advertising.

hampered by restrictions set up by manufacturers, by rigid price policies, and by indiscriminate competition fostered by manufacturers intent on increasing sales volume at all hazards.

It is difficult to view the development of private brands as other than a normal competitive device. This appears to be true, despite the fact that for individual business concerns the results may be disastrous or disruptive of long-established business relationships. The control over the market which is assured by the ownership of a popular brand with a sound reputation invites the weaker participants in the marketing process to strengthen their positions.

CHAPTER VI

THE COOPERATIVE MOVEMENT

"The cooperative movement offers the American farmer the only solution to the depression which has been with him continuously since 1920, and, at the other end of the marketing process, consumer-owned cooperative stores offer guaranteed quality standards at lower cost, retaining for consumers the normal profits of middlemen."

"American farming and American business have been built on the basis of individual ownership and individual initiative. The cooperative movement is a foreign importation which can never live successfully in this country. We don't need it, and we don't want it."

The History of Cooperation.—One of the most interesting of the current developments in marketing in the United States is the growth of the cooperative movement. The movement has received enthusiastic support, and it has been attacked bitterly. It has been made the subject of investigation by both public and private agencies. Government commissions have been dispatched to study the European cooperatives and have filed lengthy reports on their findings. Private business has "viewed with alarm" the growing strength of the cooperative idea. Its supporters have attempted to rebut the attacks by calling attention to the gains won for both producers and consumers by wisely administered cooperation. It seems safe to say that in the years ahead those engaged in distribution cannot afford to fail to study the cooperative movement, its origin, its advantages, its weaknesses, the position it occupies in marketing, and the place its supporters may win for it in the future.

Cooperation in its broadest sense is as old as human society.[1] Man, by his inherent weakness, was forced to rely on communal organization, mutual help, and collective action so early in his existence that the roots of the cooperative idea are found at the very base of human history. Actual documentation of cooperative action is available to trace its history from ancient Greece to

[1] Bakken, Henry H., and Marvin A. Schaars, "The Economics of Cooperative Marketing," Chap. II, McGraw-Hill Book Company, Inc., 1937.

the present day. This long historical perspective has great interest. For closer and more factual study, however, it is convenient to regard the modern cooperative movement, like modern marketing, as one more of the main offshoots of the economic upheaval which followed the industrial revolution.

In this sense cooperative marketing probably had its beginning with the Danish producers' cooperative movement in the mid-nineteenth century and with the consumer cooperative group organized by a group of weavers in Rochdale, England, at about the same time. After some early difficulties the movement grew rapidly in both countries and was followed by similar organizations in a number of other countries. In Sweden and England particularly, the consumer cooperative movement has had tremendous popularity and has gone through a process of integration both horizontal[1] and vertical.[2] Beginning with retail stores under cooperative ownership, the movement has expanded to include a wholesale business and the ownership of factories producing merchandise sold in the retail stores.

In Denmark "nine-tenths of the butter, nearly nine-tenths of the bacon, one-fourth of the exported eggs, two-fifths of all seeds, two-thirds of the imported foodstuffs, one-third of the imported fertilizer, and one-fourth of the exported cattle are handled by the thousands of Danish farmers' cooperative associations. . . . A fair proportion of the retail trade in many European countries passes through cooperative channels, to wit, one-fifth of the Danish, one-fourth to one-third of the Finnish, one-seventh of the British, and one-tenth of the Swedish."[3]

The cooperative movement has been very late in starting in this country.[4] At the present time there is fairly extensive use of cooperative marketing in agriculture, but the consumer cooperative movement is rather small and insignificant, although it gives some promise of increasing. It is interesting to speculate on the

[1] The association under common ownership of a number of firms performing similar operations.

[2] The association under common ownership of a number of firms operating in the successive phases of an industry, as the common ownership of iron-ore deposits, coal mines, steamships, railroads, steel mills, etc.

[3] Bakken and Schaars, *op. cit.*, p. 78. Chapter IV discusses Cooperative Marketing Abroad in recent years.

[4] *Ibid.*, Chap. III.

reasons for the popular growth of the cooperative movement in many foreign countries and the absence of that growth in the United States. There is, of course, in this country the presence of a general feeling favoring individual initiative in both business and agriculture. The farmer, especially, has been an individualist who has not wanted to have his individual freedom curtailed; consequently he has been willing to cooperate only when hard times forced him to. There is an absence of a cohesive racial group which has been found to be a desirable aid in the development of a strong cooperative movement. But perhaps more important has been the presence until very recently of an expanding frontier and of general farm prosperity. The profits from the appreciation of land value often were more important than the profits from farming. In many cases, of course, the profits from farming alone were substantial and American farmers felt little need to organize cooperatively in order to improve their economic status. More recently, since the onset of depression conditions for agriculture beginning about 1920, the cooperative movement has gained measurably in popularity and has frequently been supported by government aid. It will probably continue to gain in the future, although it is impossible at the present time to forecast the extent of its potential future expansion.

The Use of Cooperative Marketing Methods.—The use of marketing cooperatives is common throughout the field of agriculture. They are especially numerous in the marketing of grain, livestock, many fruits and vegetables, and dairy products. In distributing these products, they replace private marketing agencies or fill in where private marketing agencies have failed to provide the necessary and economical distribution of farm products. The activities of the cooperative organizations have included serving as selling agents for farmers, supplying accurate market information, and promoting the establishment of quality standards. They have frequently gone on to furnish storage, insurance, and financing services.

The single major objective of cooperative marketing has been to increase the efficiency of the marketing process. It has been hoped that higher prices might be secured for farm products marketed through cooperative associations, that the profits of middlemen might be retained for the members of the associations, that wider and more numerous markets might be tapped, and

that the purchase of farm supplies might be carried on through group buying at lower prices. Through the handling of larger volume, the cooperative associations have secured many of the advantages possessed by the large-scale individual wholesale distributors of farm products, and so have become more effective marketing agents than the individual farmer operating alone. Through the employment of experts in both production and marketing, the cooperative associations have been able to counsel the farmer on his production and marketing procedures.

To further these objectives,[1] many cooperatives have been active in improving the grading process, in branding merchandise, and in carrying on extensive sales promotion programs[2] to stimulate consumer purchase by brand of established quality standards. Some of the cooperative associations have sponsored processing activities in order to develop the markets for the products of their members. They have secured for farmers improvements in packing, storing, transportation, delivery, and credit.

Organization of Cooperatives.—There are a number of different types of cooperative marketing associations which may be classified on the basis of stock ownership, on the basis of size, according to the type of member affiliation, or according to their structure. All, however, operate under the same general methods of control and with similar objectives. The necessary capital may be secured by selling stock to the members, by borrowing from banks or the general public, or by membership fees.[3] Control, however, is retained by the members through their voting privilege. It is customary to limit the voting privilege by the rule of one vote per member, regardless of the amount of stock held, and to limit the amount of stock that any member may own. Whatever the limiting device, the general purpose is to retain a pure democratic ownership and control so that no single large producer

[1] Malott, D. W., "Problems in Agricultural Marketing," pp. 197–207, McGraw-Hill Book Company, Inc., 1938. This case discusses the activities of the American Cranberry Exchange, showing how it carries out the objectives of cooperative marketing.

[2] *Ibid.*, pp. 261–270. This case discusses the sales promotional activities of the Calavo Growers of California.

[3] Bakken and Schaars, *op. cit.* Chapters XIV, XV discuss at length methods of financing cooperatives.

may dominate the cooperative association. Earnings usually are distributed on the basis of the patronage of each member, a practice which lies at the heart of the cooperative idea and sharply distinguishes its practice from that followed in private business. The more progressive associations have set up conservative accounting standards. They maintain reserves for losses on bad debts, depreciation, and obsolescence, and are adequately financed to handle any unforeseen contingencies. They have received substantial financial assistance from the government under the provisions of the Agricultural Marketing Act of 1929, through the Intermediate Credit Banks, and under the Farm Credit Act of 1935.

The management of the cooperative association is usually placed in the hands of salaried employees. In the early history of the cooperatives this was often a source of great weakness because cooperatives were unwilling to pay the salary required to attract skillful managers. The farmer was not accustomed to a large cash income himself, and so did not feel justified in paying an adequate salary to a hired manager, nor did he see the need for getting a man of ability to manage his cooperative. In recent years he has begun to recognize the importance of securing adequate managerial talent and the necessity of offering a suitable compensation for that talent. The manager is normally responsible to a board of directors who are voted upon by the members of the cooperative group on the usual basis of one vote per member. In the small local associations this position has often been a part-time job.

One of the several types of cooperatives has become widely known as the "local cooperative marketing association." Associations of this type are usually made up of farmers raising a single product and located in a limited area which makes possible close and frequent contact. The local association assembles goods from its members and ships the products to market. It may purchase products outright from members, pool the members' crops, or market crops on an agency basis. Frequently it counsels on production problems and grading difficulties and cooperates with government officials in improving methods of production. It replaces in the independent marketing process the local buyers who purchase from farmers and ship to wholesalers in the large central markets.

Local associations of this type have a number of limitations which grow out of their small size. Because of this small size they do not have a volume of business to give them much bargaining power. They are usually in no position to brand the products of their members or to advertise those products widely, nor can they develop extensive marketing organizations which may include such facilities as the ownership of terminal marketing space, warehouses, and the provision of elaborate selling staffs. Frequently inadequately financed, they are unable to provide the research and managerial skill which the larger associations are in a position to offer.

When well managed, however, they may secure for their members a number of benefits. They may retain the profit ordinarily earned by private shippers, and divide this among the members in the form of a patronage dividend. They have successfully introduced grading, and they have been instrumental in maintaining adequate supervision over grading in order to secure satisfactory quality standards. They have encouraged farmers to increase their production of the variety and quality most in demand, and they have realized whatever economics could be secured by quantity marketing. In general, however, they have been more successful in making producers cognizant of the exact nature of consumer demand and in guiding their efforts to satisfy that demand than they have been in controlling the quantity produced. All these benefits have not been obtained by every organization or even, perhaps, by any single organization. They include the possible gains which the cooperative movement has demonstrated can be secured, some of which have been won for the members of almost every well-managed cooperative marketing organization.

The local cooperative associations are usually simply organized by individual producers in a small area with an interest in one product. By far the greatest number of cooperatives are locals. The cooperative creameries scattered throughout the north central area in this country are typical of the local cooperative marketing associations. The local livestock shipping association is one of the simplest as well as one of the most common forms of local associations. Representative local associations are also widely found in the handling of grain and in the marketing of fruits and vegetables.

The federated associations are composed of a large number of local organizations, with the central agency under the control of the local organizations. The individual producers hold membership in the local organizations which in turn are members of the federated associations. The central agency is of great assistance when the products are sold in a number of markets; their larger size and greater strength are advantageous in dealing with purchasers. Through their large organizations they are in a position to maintain adequate representation in the central markets and to carry on sales promotion efforts designed to increase the consumption of their products.[1]

The California Fruit Growers' Exchange is perhaps the best known of this type of cooperative association. It is composed of more than 200 local marketing associations grouped into 26 district exchanges. Control is vested in the agents representing the district exchanges. The exchange has built up a large sales organization, maintaining district offices in 57 of the larger markets. It has aided the members to standardize the sizes and quality of their fruits, and it has conducted very extensive promotional campaigns which have been effective in increasing the per capita consumption of citrus fruits throughout the entire country.

The third type of cooperative marketing association is the centralized association. This organization is distinguished from the federated type by the centralization of control at the main office. Individual producers belong directly to the central association rather than to the federated groups which in turn support the central association. Associations of this type usually cover a very wide territory and ship from many local points. Frequently there is a contractual relationship between individual members and the central association. By reason of its size, the centralized association is able to maintain representation in the largest markets and to engage in extensive advertising. The Washington Cooperative Egg and Poultry Association is an example of a centralized association. Approximately 18,000 members own stock in this association.

The Government and Agricultural Cooperation.—Perhaps more than any other type of marketing institution, agricultural cooper-

[1] Learned, E. P., "Problems in Marketing," pp. 164–170 McGraw-Hill Book Company, Inc., 1936. This case discusses the sales policies of the LandO'Lakes Creameries, Inc., a federated association.

ative associations have required government aid both for clarifying puzzling legal situations and for offering counsel and financial assistance during the period of initial organization. During the latter half of the nineteenth century numerous states enacted legislation authorizing the incorporation of cooperative marketing associations. Federal laws were delayed, and the legal position of marketing cooperatives in interstate commerce was not clearly established until 1922. Supplementary legislation followed leading up to the Agricultural Marketing Act of 1929 which provided, among other things, a revolving fund of 500 million dollars from which loans were to be made to cooperative associations.

Ever since the passage of the Agricultural Marketing Act of 1929 the Federal government has been actively assisting the formation and operation of cooperative marketing associations. The Federal Farm Board and, more recently, the Farm Credit Administration have worked to merge local and regional cooperatives into national cooperatives and have had the further objectives of increasing the bargaining power of farmers through their cooperatives and of stimulating better merchandising methods.

Independently and with the support of governmental agencies, the agricultural cooperative movement has had a very extensive growth in this country. The California Walnut Growers' Association regularly markets about 85 per cent of the country's walnut crop. The California Fruit Growers' Exchange handles almost 75 per cent of the citrus fruits produced in California and Arizona. About 15 per cent of the cotton grop, 35 per cent of the butter, and 30 per cent of the Florida citrus fruit crop are sold cooperatively.[1]

Through the cooperative marketing associations producers have been benefited by their retention of the middlemen's profits; by increased business efficiency; by improved methods of growing, packing, and shipping developed by the cooperative sponsorship; and by the grading and standardization of their products. The fruit cooperatives, in particular, have been successful in improving the methods of production used by their members.

[1] Fetrow, Ward W., Cooperative Marketing of Agricultural Products, *Farm Credit Administration, Cooperative Division, Bulletin* 3, 1936. Also see J. G. Knapp and J. H. Lister, Cooperative Purchasing of Farm Supplies, *Farm Credit Administration, Cooperative Division, Bulletin* 1, 1935.

Elements of Strength and Weakness in Cooperative Marketing. The major weaknesses of the cooperative marketing associations have centered around the difficulties of controlling the supply of farm products, difficulties which also constitute a problem for individual farmers selling independently. The cooperatives have made spectacular gains in quality control and in the development of orderly marketing methods. They have not succeeded in developing control of the quantity supplied and, therefore, have not been entirely successful in extending their control over price movements.

More orderly marketing of seasonal farm crops has been a major benefit derived from the cooperative marketing movement. Operating with the aim of shipping merchandise to the right place at the right time and selling for the right price, cooperatives have eased the distribution of perishable products and have been instrumental in avoiding the gluts and dearths which create major price fluctuations in our leading markets. They have placed their financial strength at the assistance of individual farmers who would otherwise be forced to dump their crops at harvesttime without regard for the prevailing price. They have provided storage facilities and financial assistance to make possible the carrying of perishable and semiperishable products and the diversion of crops from poor to good markets.

They have been successful also in securing some reduction in the costs of marketing. These savings have proceeded from the lower cost of quantity handling as it affects storage, freight rates, and packaging. They have not, however, reduced the cost of distribution as much as many of their supporters expected, since, here as elsewhere in marketing, a change in the agent performing the marketing functions does not necessarily include a change in the functions performed. Thus the substitution of cooperative marketing associations for independent middlemen does not eliminate the necessity of performing the functions performed otherwise by the independent middlemen. Savings result only from the more efficient performance of the same functions by the cooperative or from such economies as may proceed from mass distribution.

The major elements of weakness in the cooperative marketing movement have centered around three points: inadequate managerial skill, lack of support by the members, and failure to extend control over the product. Cooperatives have also

failed when they were organized to serve a need which did not exist, *i.e.*, when marketing through independent middlemen was efficient and economical. Lack of loyalty on the part of the members and the failure to secure a sufficient volume of business necessary for efficient management have often been partly responsible for their lack of success. In some cases farmers have been reluctant to agree to the pooling of their products necessary for the success of cooperative marketing. In certain cases failure to standardize the products has handicapped the cooperative associations. In others, the attempt to market through a single cooperative the products of a number of widely scattered producers without a common interest has ended in failure. Members sometimes expect too much from their cooperatives and become disloyal when their expectations are not realized. Members are often unwilling to sacrifice present profits in order to build future financial strength. A great many of these difficulties can be gathered together under the heading of insufficient managerial skill. In part this has been due to the unwillingness of cooperative members to pay salaries high enough to attract skillful managers. Again it has been due to unwillingness to grant the managers administrative freedom. In part, it has been due to the failure to realize how much capital was needed for successful organization and operation. At times, it has been due to the failure to build adequate reserves for unforeseen contingencies.

The successful associations have usually centered their activities around the marketing of one product or a few closely related products. They have strengthened both the desire and the need for cooperative group action. Their members have known both the possibilities and the limitations of cooperative action, and they have realized the importance of managerial skill and the necessity for building adequate financial reserves. Against this background a number of the largest associations have developed very extensive and complex marketing programs. They have maintained permanent agencies in the large central wholesale markets, and they have also secured the profits obtained by brokers, commission men, and wholesalers. They have advertised widely to stimulate consumer demand for their products. They have established and maintained grades, and they have assisted producers to offer crops suitable for marketing under

these standards. They have brought to the market giant bargaining power which has been instrumental in securing for their members higher prices. They have improved marketing methods. They have established warehouses and storage plants, and they have acquired great skill in transferring products between markets in order to insure a continuous supply sold at the highest possible prices in all the wholesale markets.

One of the important instruments employed by the cooperative associations in developing their marketing programs has been the pooling process.[1] Here the products of all the farmers in the cooperative are grouped together and offered for sale by the cooperative without regard for individual ownership. Each farmer's crop is lost in the group, and he receives the average price secured for the entire pool for that particular quality of product in proportion to the amount he contributed to the pool. Pools may be organized on a daily, weekly, monthly, or yearly basis. Pooling offers an opportunity to spread marketing risks among farmers on what may be termed a self-insurance basis. Because of the larger volume handled, it gives the cooperative a more commanding position in marketing with a greater control over prices. Objection to pooling is frequently raised by members who think that, if they retained control over the marketing process, they would have received prices higher than the average.

Consumers' Cooperative Stores.—The fundamental laws developed by the Equitable Pioneer Society of Rochdale, England, almost 100 years ago are still generally in use today as the basis for all types of consumers' cooperatives throughout the world. They embrace the following principles: one vote per member; open membership; fixed rate of interest paid on invested capital, but no dividends paid on invested capital; surplus savings to be used (1) for the establishment of a reserve fund, (2) for conducting educational work among members, (3) for payment of dividends in proportion to the amount purchased during each annual period; and, finally, the business to be run primarily for the service of the members.

The growth of the consumer cooperative movement throughout the world has been impressive. Cooperative societies in 38 countries have formed an international alliance with which are affiliated almost 100 million members. The societies have

[1] Bakken and Schaars, *op. cit.*, Chaps. XVI, XVII.

grown beyond the operation of retail stores. In many cases they have extended their control over wholesalers and have even organized their own factories to produce certain types of merchandise which were not available or which were believed to be inadequately supplied by independent manufacturers.

In the United States the growth of cooperative stores has been much less rapid. Although the first cooperatives were organized as early as 1845, even at the present time their share of the retail trade is very small. The most recent estimate is that there are approximately 6,600 cooperative consumer organizations in the United States with a total annual volume of about 365 million dollars. Much of this growth has occurred within the past 5 years.

The reasons for the slow growth of consumers' cooperatives in the United States[1] are generally similar to those responsible for the relatively slow development of producers' cooperatives: the absence of an integrated racial or social group, poor management, failure on the part of the members to realize the possibilities and weaknesses of cooperative undertakings, and, perhaps most important, the presence in this country of a large number of chain stores organized on a more efficient basis than independent stores in other countries. The incentive to organize consumers' cooperatives in order to provide better merchandise more cheaply has been lacking, and the movement has progressed recently only under the stimulus of a severe depression.

The consumers' cooperative movement rests upon the same basis as does the producers' cooperative. Consumers cooperative stores must perform the same functions as do independent stores, and unless they can perform those functions more cheaply, they will not realize as large profits for their members or be able to offer merchandise at lower prices.[2] They have, of course, certain advantages which may result in economies in operation.[3]

[1] Drury, J. C., Consumers' Cooperation, *The Journal of Marketing*, April, 1937, p. 385.

[2] Palmer, J. L., Can Consumer Cooperation Correct Important Defects in Marketing? *The Journal of Marketing*, April, 1937, p. 390. A pessimistic view of the cooperative's ability to strengthen the weaknesses of present marketing methods.

[3] Schmalz, C. N., "Operating Results of Consumer Cooperatives in the United States in 1937," *Harvard University Graduate School of Business Administration, Bureau of Business Research, Bulletin* 108, 1939.

With the patronage of their members secured, they do not have to set aside a portion of their sales for advertising. In many cases the members may be willing to forgo certain services, such as delivery and credit, which they would expect and demand in an independent store in which they had no ownership interest. Cooperatives may operate successfully in inadequate and out-of-the-way locations which would not be available for independent stores which must have central locations in order to attract consumers. Most consumer cooperatives can be placed in one of three groups:[1] (1) food store cooperatives, (2) general store cooperatives, and (3) farmers' supply cooperatives.

Increasingly in the last few years, attention has been directed to the possibilities of consumer cooperation. With government aid, and supported by a more active consumer movement, its future progress may well prove to be much more rapid than its past history would indicate. Throughout the cooperative movement, however, for both producers' and consumers' cooperatives, success must depend upon the more efficient performance of the marketing functions normally carried on by private business.

[1] *Ibid.*, p. 1.

CHAPTER VII

DIRECT MARKETING

"Most manufacturers, when they undertake to market their products direct to retailers, do so without a full understanding of the risks and the costs of direct marketing. If they knew more, they would do it less. The tendency toward direct marketing in the past few years has really been a fad, without a sound basis in rational business practice."

Selecting Channels of Distribution.—The selection of the proper channels of distribution for his merchandise is one of the most difficult problems with which a manufacturer has to deal. Should he sell to wholesalers and permit them in turn to sell to retailers? Should he sell direct to retailers himself? Or, possibly, should he, himself, undertake to sell direct to final consumers? What are the comparative costs of selling by these various methods? Are comparative costs alone a sufficient basis for making this decision or are there other factors to consider? How much weight should be given to competitive practice in his industry? What control should be exercised over the sale of his products? How much is absolutely necessary? How much is, perhaps, desirable? Should wholesalers, if they handle his merchandise, be permitted or encouraged to sell to all retailers or should they be restricted and allowed to sell only to a few retailers in each town? If there are to be restrictions, what should they be? If sale is to be made only to selected retailers, should he then sell to all wholesalers? Is direct sale necessary for proper selection of retail outlets? If direct sale costs more than sale through wholesalers, are there compensations in the form of proper selection of retail outlets and better control over retail inventories? Should his products be sold direct in some territories and through wholesalers in others and, if so, what criteria are available for aiding in reaching that decision?

All these questions circle around the problem of when and where and how to undertake direct marketing. Not costs alone, but cost and necessary control over brand protection and

distribution policy and merchandise protection and dealer contacts and consumer satisfaction, as well as many other considerations, must enter into the formulation of a manufacturer's marketing policy.

What Is Direct Marketing?—Theoretically, the phrase "direct marketing" denotes sale by producers direct to ultimate consumers. In practice, however, the phrase is usually employed to describe sale by producers direct to retailers without the transfer of merchandise through wholesalers or other middlemen. There are, of course, a few types of marketing procedures in which producers sell direct to final consumers, but they are not common. The term may also be used to describe sale by wholesalers direct to final consumers. In some cases it may describe the marketing practice of a manufacturer who establishes his own retail stores and sells direct to consumers. It may even be employed, as it is in this chapter for the sake of convenience, to describe all types of selling by the mail-order method. The common business use at the present time usually describes that marketing procedure which eliminates the wholesale middleman.

Reasons for Direct Marketing.—The increasing use of this type of marketing has already been discussed in the chapter dealing with various types of wholesalers. On one hand, manufacturers, seeking to extend control over the marketing of their products, have reached forward in the marketing process by attempting to sell direct to retailers. On the other hand, large chain-store organizations and associations of independent stores have attempted to extend their control over the marketing process for those products which they purchase and have developed the practice of buying direct from manufacturers. Both these developments in the past two decades have been instrumental in diverting into various types of direct-marketing procedures part of the merchandise which formerly flowed through wholesale channels. The tendency of manufacturers to produce wider lines has made direct marketing possible where formerly its cost would have been prohibitive.

There is no indication at the present time that this movement will continue until all wholesalers have been eliminated. In fact, there is ample evidence to indicate that throughout the marketing process there are many situations where sale through wholesalers is the most efficient and the lowest cost method of

distribution. As long as the wholesaler continues to occupy this position, there is no reason to expect him to cease to function. It is clear, however, that developing competition and the increased offering of new products are leading producers to assume more and more of the task of marketing and merchandising. In so doing they have to a large extent encroached on the territory of the wholesaler.

Importance of Modern Transportation and Storage.—Improvements in transportation have, of course, had their effect upon this simplification of the marketing process. Better roads and quicker transportation have made possible a larger volume of sales direct to retailers. They have made it easier for manufacturers to deliver merchandise to retail stores quickly and on short notice. Public warehouses[1] have played an important part in making it possible for manufacturers to eliminate wholesalers and sell direct to retailers. Through the elaboration of their services public warehouses are able to perform for manufacturers the functions normally allotted to wholesalers.[2]

Advantages of Direct Marketing.—The following advantages lead manufacturers to extend their direct-selling activities: better control over selling processes, easier contact with large-scale buyers, better control over services and technical advice necessary for certain products, more control over price and selling terms, greater speed in distribution of perishable products, and, possibly, lower costs of transportation. Many manufacturers may be willing to sacrifice low-cost transportation for such gains in control over the distribution process as they may secure through direct marketing. In some cases, of course, direct marketing may be effective in reducing selling costs. Frequently a manufacturer may discover that direct marketing will be beneficial for part of his line,[3] or in certain territories, while the use of wholesalers may be desirable for other products or in other territories.

Direct sale is the common method of distribution employed in selling new and unknown types of merchandise which require

[1] Haring, Albert, The Public Warehouse: An Essential Tool in Wholesale Distribution, *The Journal of Marketing*, October, 1936, p. 106.

[2] See Chap. XII of this text.

[3] Standard Brands sells its Fleischmann's Yeast direct to the retailer, but sells its Royal Baking Powder through wholesalers.

special initial sales promotion efforts in excess of what a wholesaler may normally be expected to offer. Occasionally a manufacturer of perishable or semiperishable products may hesitate to entrust such merchandise to wholesalers because of the possibility of its reaching consumers in a deteriorated condition. Desiring to be absolutely certain that consumers will be satisfied with the quality of his merchandise, he may choose to sell direct to retail stores in order to guarantee the freshness of the merchandise and to prevent overstocking retailers.[1] He may take this step even though it may cause a rise in his cost of distribution.

In 1929, approximately 83 per cent of the total dollar sales of industrial goods were made direct to business purchasers,[2] and in 1935, 24.5 per cent of manufacturers' sales of all types of merchandise were made direct.[3]

Industrial Goods—Direct Sale.—Because of the nature of the merchandise and the type of buyers and sellers involved, industrial goods are usually sold by direct-selling methods without the intervention of wholesalers.[4] This method of distribution is used when buyers and sellers are large; when the merchandise requires salesmen with technical knowledge; when products are made to order following buyer's specifications; or when the unit of sale is very large, so that the higher expense of direct selling is only a small proportion of the selling price. In other cases the need for expert repair may make it necessary for the manufacturer to maintain direct contact with his customers and undesirable for him to entrust this repair work to independent wholesale outlets.

How Integration Facilitates Direct Marketing.—Frequently in actual business practice direct marketing is one of the results of the merger of several firms engaged in the distribution of similar merchandise. At times the mergers are completed to take advantage of the possibilities of direct marketing. At other

[1] Standard Brands: Merchant on Wheels, *Fortune*, January, 1938, p. 77.

[2] U.S. Department of Commerce, Bureau of the Census, Census of American Business, Wholesale Distribution, Summary of the United States, p. 6, 1933.

[3] U.S. Department of Commerce, Bureau of Census, Census of American Business, 1935, Wholesale Distribution, Vol. I, p. 6, 1937.

[4] Frederick, J. H., "Industrial Marketing," pp. 84–94, Prentice-Hall, Inc., 1934. These pages explain the reasons for direct marketing of industrial products.

times direct marketing is a by-product of the formation of large business units. A number of the companies engaged in the distribution of semiperishable food products have been formed as a result of mergers which had, as at least one of their major objectives, the possibility of utilizing direct-marketing procedures not available to the independent companies. As small companies they were unable to sell their products direct to retailers because of the high cost of distributing a limited line of products through their own salesmen. When, as a result of the merger, the parent company became the sponsor of a wide line of food products, direct sale through the company salesmen was less costly, and the other benefits centering around control over the inventory of semiperishable merchandise were realized.[1]

The same type of reasoning applies to the use of direct-marketing procedures resulting from the organization of large-scale chain-store companies. As small chain-store companies they were probably unable to purchase directly from manufacturers because the wholesale functions could be performed most efficiently and economically only on a large scale. By the merger of a number of small chains, there was produced an organization capable of performing the wholesale functions as economically and efficiently as any wholesaler, securing, perhaps, even greater economies through the elimination of selling and sales promotional work among retailers. So, too, a number of manufacturers of similar products may merge their companies and, as a result, find themselves in a position to market their products direct to retailers because of the availability of a wide line for their salesmen to handle.

Cost versus Other Factors in Direct Marketing.—The cost of direct marketing, therefore, is one of the major criteria which determine the use of this method of distribution. On occasion, however, cost may be sacrificed when other considerations, such as control of quality or control of the inventories of retail stores, become dominant and it is necessary to take extra precautions to maintain the reputation of an advertised brand. Producers tend to sell in that manner which guarantees them the highest return. This usually means seeking the lowest cost method of distribution. It may, however, on occasion, as indicated above,

[1] Standard Brands, again, offers an excellent example of the advantage of such a merger.

mean seeking a high-cost method of distribution which preserves necessary control over the products and so, in the end, tends to increase the return to the producer.

The profits of most middlemen are not excessive. The opportunities for securing major economies by shifting from indirect- to direct-marketing methods are limited. The manufacturer attempting to sell directly to retail stores must realize that the cost of selling in this manner will be high. He must, in almost every instance, duplicate the middleman's sales organization, and frequently he must maintain this sales organization with a small volume of sales. This necessitates the incurring of higher costs per unit sold. In addition, when the manufacturer undertakes to sell direct, he is endeavoring to administer a new type of business, one in which he may have had little experience. The problems raised in this new type of business are often so difficult that the necessary administrative skill is lacking. For a period of time following the initiation of direct-selling methods, costs may be unusually high because of the inexperience of the manufacturer in dealing with wholesale-selling problems.

Disadvantages of Direct Marketing.—It is important to notice that in every instance the manufacturer who endeavors to replace the wholesaler must offer the retailer the same services and must perform the same functions which were undertaken by the middleman. Unless this can be done on a lower cost basis or unless the control of distribution policies so secured is necessary, the move toward direct marketing may in the long run help to diminish profits.

To trace the disadvantages of direct marketing, therefore, it is necessary only to point out the many services which are normally performed by wholesale middlemen and which must be undertaken by the manufacturer who desires to sell direct. Direct marketing will lead a manufacturer to increase the size of his sales organization, to sell to a large number of small consumers, to extend credit where his knowledge of financial conditions may be limited, to undertake difficult and expensive delivery and repair services, and to support an important increase in the administrative burden of his business. There are obviously conditions under which these difficulties must be faced. Just as obviously not every product nor every manufacturer is adapted to direct-selling methods. Obviously,

too, a manufacturer may find it advisable to sell part of his line by direct-sales methods and part through the normal wholesale channels. He may find it advisable to sell by direct methods in one territory and not in another. In every case the decision will be made on the basis of the comparative costs or the comparative control over distribution which is desired. If direct sale is cheaper, it will, of course, be undertaken. If direct sale is more expensive but may be accompanied by necessary control over the products distributed, it may still be undertaken under certain conditions. If direct sale is more expensive and is not accompanied by necessary increased control over distribution methods, it should not be undertaken.

House-to-house Sale of Farm Products.—There are a number of ways in which farm products are sold by the direct-marketing procedure. They may be sold from house to house, or at farmers' markets, or at supervised public markets. They may be sold by parcel post or, very commonly, at roadside stands.

House-to-house peddling is usually carried on by farmers living near small towns or the outlying sections of large cities. The commodities marketed in this way are fruits, vegetables, poultry, eggs, and dairy products. Direct marketing by house-to-house selling offers a quick market for perishable products at a price certainly in excess of that which could be secured for surplus commodities offered through the regular marketing channels. Consumers are led to buy from house-to-house peddlers because of their belief that such products are fresher and of better quality. Prices may be somewhat lower than the prices asked for the same articles at retail stores. The method of purchase is convenient in one way because it eliminates the difficulty of going to the store to make the purchase and carrying merchandise home. In another way it is inconvenient, since the peddler does not always come when the customer is ready to purchase and may not be available when fruits and vegetables are needed. For the farmer, on the other hand, direct sale by this method is time consuming and may incur unrecorded costs sufficient to wipe out the profits secured from the sale.

Farmers' Markets.—Sale of farm products direct to consumers at farmers' markets was formerly an important part of the distribution of farm products. More recently it has been declining in importance largely because of the waste of time in buying and

selling, and the competition offered by well-stocked neighborhood grocery stores. The physical facilities for farmers' markets are provided at public expense in some cities, in others by private undertaking. A wider variety of fresh merchandise may be offered for sale than at the typical retail grocery store. A number of limiting factors, however, must be considered. Traffic congestion around the market is heavy. Parking facilities are often limited. Customers must pay cash and carry home their purchases. They may have to travel some distance to make purchases and, therefore, have to plan their shopping lists rather carefully in order to avoid omitting merchandise which will be needed in the following days. The compensation for purchasing in this rather awkward and inconvenient fashion is the assurance of securing fresher merchandise direct from the farm and, possibly, some saving in price. Price differentials between merchandise offered at these farmers' markets and merchandise in the regular retail stores vary from city to city. Prices in the farmers' markets are rarely higher than retail store prices, but they are not always markedly lower.

Sale of Farm Products by Parcel Post.—The Department of Agriculture and the Post Office Department have devoted some attention to the stimulation of sale by parcel-post methods.[1] This method of distribution, however, has never been very successful. In theory, it provides prices for the farmer higher than he can receive through the normal marketing channels, and for the consumer prices lower than those she would have to pay for similar merchandise in retail stores. In theory, also, the farmer secures an outlet for merchandise which can be sold in quantities smaller than other methods of distribution will accept.

The consumer, in turn, in addition to a lower price, may secure fresher merchandise. It is at best an inconvenient and difficult method of purchase. The consumer must buy without inspecting the merchandise. She must plan her shopping very carefully, often several days in advance of the arrival of the merchandise. She must anticipate her needs, and she finds it difficult to make adjustments. There are other difficulties for the farmer. He has to assume packing and container costs. He often finds it difficult to acquaint customers with the variety

[1] Learned, E. P., "Problems in Marketing," pp. 1–3, McGraw-Hill Book Company, Inc. 1936.

of merchandise he has for sale, as well as with price changes. Disputes over quality, damages, or prices are not easily settled through the mail, and consumer dissatisfaction is not usually made apparent to the farmer with sufficient speed to permit him to make adjustments and corrections before purchasing ceases.

Roadside Marketing of Farm Products.—The last type of direct-marketing method for farm products which should be mentioned is one which has grown in popularity with the increased use of the automobile. Roadside marketing stands[1] are common sights on all our main highways. They offer a convenient method of purchase for consumers when out driving; usually prices are somewhat lower than retail prices, and there is a reasonable guarantee of fresh merchandise. For the farmer the roadside stand offers quick disposal of surplus produce at prices higher than would be offered by the normal channels of distribution. Against these higher prices, however, he must balance the time consumed in selling by this method.[2]

Mail-order Houses.—Selling by mail is resorted to by manufacturers, wholesalers, and retailers under various conditions.[3] The mail-order business has been in the past a very important part of the distributive process for all types of merchandise.[4] That importance has been declining in recent years, but it still plays a significant part in the distribution of merchandise.

More than 1 per cent of the total volume of retail business is carried on by mail-order houses. To that figure, however, must be added sales made to retailers by manufacturers through direct-mail methods. Confining our attention for the moment to the sale of merchandise by mail-order methods direct to consumers, we find that in general the expenses of operation for mail-order houses tend to be somewhat lower than the expenses

[1] Malott, D. W., "Problems in Agricultural Marketing," pp. 47–57, McGraw-Hill Book Company, Inc., 1938.

[2] In many cases the wife and children supervise the roadside stand, thus freeing the farmer for his usual work.

[3] Barker, C. W., and I. D. Anderson, "Principles of Retailing," pp. 22–26, McGraw-Hill Book Company, Inc., 1935.

[4] Mail-order houses can be grouped into four classes: (*a*) general mail-order houses (Sears, Roebuck and Co. and Montgomery Ward & Co.), (*b*) specialty mail-order houses (selling one article or a narrow line of articles by mail), (*c*) retail-store mail-order departments, (*d*) magazine and professional mail-order shoppers.

of operation for department stores and perhaps a little higher than the expenses of operation for small-town general stores. Surveys have demonstrated that mail-order houses which distribute a general line of merchandise have lower expenses than do those which specialize in a single type of merchandise. Expenses also may be lower where there is a substantial amount of repeat business. It has been stated that it is difficult to sell profitably by mail an article costing less than $1 unless there is a fair amount of repeat business.

Advantages and Disadvantages of Mail-order Selling.—Buying from a mail-order house is not the most convenient method of purchasing for the average consumer. Since consumers tend to purchase in the most convenient manner unless offered other compensations for the burdens imposed by out-of-the-ordinary purchasing methods, mail-order houses have had to resort to price appeals in order to stimulate buying. The consumer buys from a mail-order house for one or both of two reasons: to secure lower prices or to obtain merchandise not available in local stores. Mail-order houses had their first success because they offered merchandise at lower prices and because they made this merchandise available to consumers in rural areas where local stores carried only limited lines of merchandise. In recent years, with the development of surfaced roads and the widespread ownership of automobiles, consumers in rural areas have tended to transfer their purchasing from mail-order houses to retail stores which can now be reached more easily and quickly from the farms.

Mail-order expenses are lower because no salesmen are employed and because the companies are not burdened with expensive locations and the costs of maintaining attractive retail stores. Shipments can often be made direct from the factories to the consumers. At the same time the mail-order house by securing its business from a national market may avoid the burden of local depressions as an adverse influence upon business.

The limitations of mail-order selling, on the other hand, are also obvious. Consumers like to see what they buy before purchasing. Under the mail-order method of selling, they are forced to rely upon pictures and descriptions. There is no personal salesmanship, often an important factor in leading to sale. There may be some delay in delivery. The purchaser

has little opportunity to engage in discussion about the merchandise with the house from which he buys, and if he wishes to return merchandise or if he is dissatisfied with his purchase, he finds it difficult to register his complaint. For the same reason the mail-order house is handicapped in meeting the objections of buyers. Merchandise which requires demonstration for effective selling suffers. The extension of credit to consumers at a great distance may involve considerable risk for the mail-order house. Merchandise which requires service or repairs often is handicapped in comparison with the sale of the same merchandise in retail stores. The mail-order process, with its attendant delays, also limits the possibilities of selling perishable merchandise. For all these reasons, despite the obvious advantage of somewhat lower prices and in many areas the possibilities of securing merchandise not available in local stores, consumers have not centered all their purchases with mail-order houses.

Other Problems of Mail-order Houses.—There are other problems connected with mail-order selling which should be mentioned. The first cost of placing a catalogue or an advertisement in the hands of a potential consumer is high. Unless the unit of sale is large, either because of the high price of the single article purchased or because of the purchase of a number of articles simultaneously, there must be the promise of repeat sales to insure a profit. The one-time sale of an inexpensive article by the mail-order method is usually an unprofitable sale.

As a result of the change in consumer buying habits in rural areas following the development of first-class roads and widespread automobile ownership, two of the leading mail-order houses have expanded their operations into the retail field. They have opened a number of retail department stores designed to appeal to those customers who formerly purchased by the mail-order method as well as to many of those interested in economical purchase. By going outside the mail-order field, they have maintained and even increased their sales volume at a time when the normal market for their particular method of distribution was declining for reasons beyond their control.

House-to-house Selling.—Many types of consumers' goods are sold from house to house by specialty salesmen.[1] Goods distributed in this manner include convenience merchandise,

[1] The Fuller Brush Company, *Fortune*, October, 1938, pp. 35–36.

some types of shopping goods, and a number of varieties of specialty goods. They vary from inexpensive household gadgets to vacuum cleaners and refrigerators, and include silk stockings and household brushes.[1] The house-to-house method of direct selling obviously presents many difficulties for both manufacturer and consumer. It is an expensive method of selling for the manufacturer. Usually his salesmen are paid on a commission basis, and, since they must make many calls to make one sale, the commissions must be very large. There are, in addition, the costs of hiring, training, and supervising the salesmen and of packing and shipping the merchandise in small quantities. The same difficulties are encountered here which were found in direct-mail selling; the cost of making a single sale is high, and, to earn a profit, the manufacturer must expect to sell a number of products at a single interview if their price is low, or to sell a product at a high price if only one unit can be sold at an interview.

From the consumer's point of view the house-to-house method of buying has many limitations. The salesman may come to the door at a time inconvenient for the housewife. Selling by this method has been cheapened because of the activities of a number of disreputable salesmen offering inferior products. If the article is one which is purchased frequently, the consumer has to anticipate her needs in order to purchase at the salesman's convenience.

That this method has persisted, however, is good evidence that for certain types of products it is perhaps the best method of sale. For those products, for example, which require household demonstration before purchase, it is obviously the best method of sale. For other products new to the market for which manufacturers find great difficulty in securing satisfactory wholesale and retail outlets, house-to-house sale may be effective for an introductory period. Many products are first brought on the market in this way and later sold through the regular wholesale and retail channels.

Some of the most successful exponents of this method of sale, aware of the difficulties involved, have devoted a large part of their consumer advertising appropriations to publicity designed to introduce the salesman to the home. Their advertising describes the reliable type of salesmen they employ and

[1] *Ibid.*, p. 69.

urges that they be given an opportunity to demonstrate their merchandise. Such advertisers may devote little space to describing the virtues of their products, realizing that the actual sale is made by the salesman, not by the advertising.

Wholesale Buying by Consumers.—Another form of direct marketing, wholesale buying by consumers,[1] is considered unethical by retailers. In this case the initiative for the direct contact comes from the consumer rather than from the manufacturer. Employees of business firms do this personal buying through the purchasing departments of their firms.[2] The object is merchandise at lower cost for the ultimate consumer rather than to benefit the manufacturer. The consumer tries to go over the head of the retailer and buy from the wholesaler, or also to go over the head of the wholesaler and buy direct from the manufacturer. In some cases the consumer does get the product at a lower price, but in many cases the price is equal to or greater than the regular retail price.

[1] Taylor, H. D., Wholesale Buying by Consumers, *The Journal of Marketing*, October, 1937, p. 113.

"Diversion of Trade from Retailer Channels," Chamber of Commerce of the United States, 1939.

[2] It has been estimated that more than a billion dollars annually escapes the regular retail stores by this method of buying.

CHAPTER VIII

SMALL-SCALE RETAILING

"The small retailer is finding it more and more difficult to maintain his competitive position. He is losing out to the chain store. His customers are dropping away. His sales are declining. He cannot expect to remain an important part of retail distribution for many more years."

"Only the inefficient among the small retailers have been forced out of business. The small retailer who is a skilled store operator has nothing to fear from the chain store. He is a strong competitor."

The Nature of Retailing.—One end of the marketing process lies at the farm, the forest, the mine, and the factory; the other lies at the retail store across the counters of which pass the streams of merchandise purchased by consumers. An increase in the flow of goods across retail counters is reflected farther back in the distributive process by a quickening of wholesaling and of manufacturing. A decrease in the volume of retail sales is also quickly evident in the lessening pace of wholesaling and manufacturing. Changes in tastes make themselves felt at this point. New styles are accepted or rejected. Pressure may be exerted to lower prices or to develop new services or even new types of stores, for this is the end which shapes all marketing. This is its vital moment, when a prospective customer with the money to pay for his wants enters a retail store and begins to select his purchases.

The activities of retailers are no mystery. As consumers you have been in continuous contact with retail stores for a great many years.[1] It may be enlightening, however, to subject the activities of retailers to some analysis which will break down what they do into a series of simplified operations. They buy from manufacturers or wholesalers and sell to consumers. They may extend to consumers a number of services, such as a con-

[1] Barker, C. W., and I. D. Anderson, "Principles of Retailing," pp. 1–2, McGraw-Hill Book Company, Inc., 1935. The service which the consumer receives from the retail store is discussed.

venient place in which to purchase, credit, delivery, the assistance of a salesperson, and, in the case of department stores, a great many auxiliary services. As merchants they bear all the risks of ownership, the dangers of price change, of style change, and of deterioration of merchandise. They store merchandise between the time of purchase and the time of sale. They advertise to acquaint consumers with their offerings. Frequently they assist in stimulating a demand for merchandise, which in the long run may help to reduce its price.

Within his own sphere the retailer, large or small, really performs all the marketing functions. He sells in a variety of ways. He uses every known device of publicity. He may grade merchandise. He stores and transports it. In recent years he has been very active in testing merchandise and establishing quality standards. Situated between the consumer and the source of supply, his primary job is to understand and interpret consumer demand and endeavor to satisfy it by skillful purchasing from manufacturers and wholesalers.

Classification of Retail Stores.—Like the other marketing institutions with which we have been dealing, retail stores may be classified in various ways. These classifications are based on variations in the type of merchandise handled (shoe stores, grocery stores, drugstores), the size of the store (large stores and small stores), the location of the store (downtown stores and suburban stores), the types of services offered (service stores, nonservice stores, or cash-and-carry stores), and the method of administration (independent stores and chain stores). The classifications may, of course, overlap. There are chain stores which sell only groceries, and there are also chain stores which deal in general merchandise. Placing a store within a broad classification, however, may be helpful in understanding its organization, its competitive position, and its operating problems.

Characteristics of the Independent Retail Store.—The type of retail store which outnumbers all the others and which transacts the largest part of the total volume of business is the independent retail store. Independent stores include as much as three-fourths of all the stores in the United States, and they handle slightly more than half of the total retail business. Most of the stores of this type are small with an annual sales volume of less than $50,000. The classification of independent stores, however,

may also include large department stores which still remain free from affiliation with other retail stores or with wholesaler or manufacturer organizations.

Independent stores are found in cities and towns of all sizes. They sell all types of merchandise. Some specialize as single-line stores; others serve as general or department stores. Some offer no services and sell their merchandise on a cash-and-carry basis. Others, among which may be listed our leading department stores, offer very extensive services. Within the classification of independent retail stores may be found examples of every type of retail outlet from the "hole-in-the-wall" grocery store to the largest metropolitan department store.

The General Store.—One of the oldest varieties of independent retail stores is the general store.[1] This type of retail outlet grew up in rural areas and in small towns where the population was too limited to support a large number of stores or to support single-line specialty stores. The general store sold everything from the proverbial mousetrap to the equally proverbial postage stamp. It appealed to its customers largely because of its ability to supply all their needs whatever they might be, and to supply those needs quickly at a moderate price and often with the extension of credit. The manager knew his customers well, and they enjoyed their contacts with him. In recent years, with the development of better roads and transportation, the old country general store has been declining in importance. Its customers prefer to drive to a near-by city and to purchase there in larger stores with more complete stocks of merchandise. This is particularly true when the customer is buying shopping and specialty goods. The general store continues to offer valuable services in the sale of convenience merchandise for which most people are unwilling to travel great distances. But its merchandise stocks are necessarily limited, and its buying power and the small volume of retail trade which can be attracted to rural shopping points handicap it in purchasing at advantageous prices. There is little doubt that it will continue to exist in its particular field, supplying convenience merchandise to rural customers. The absence of an aggregate of purchasing power at country points will effectively prevent the entrance of chain-store competition.

[1] *Ibid.*, pp. 6–9.

The Single-line Store.—In contrast to the general store there is the single-line, or specialty, store which appears in cities both large and small.[1] Stores of this type carry only one kind of merchandise. There are grocery stores, drugstores, shoe stores, and specialized stores selling many other kinds of merchandise. Specialized stores need a larger body of consumers than do general stores. They may be called a development which has followed the growth of larger centers of population. Such specialized stores as grocery stores may be found in very small towns. In larger towns specialization may be extended to clothing stores or shoe stores. In very large cities specialization may go even farther by limiting not only the type of merchandise carried, but also its price; one-price clothing stores or one-price shoe stores are usually located in large cities.

Advantages of the Single-line Store.—By specializing on one type of merchandise, the single-line store is able to realize a number of advantages. There is a larger accumulation of purchasing power than is encountered in the general store. The large sales volume derived from the single type of merchandise makes possible the carrying of much more complete stocks than the general store can offer. Specialization within a single merchandise line develops in the store manager skill in handling merchandise of that type, skill in buying and in selling, and, through experience, greater aptitude for advertising, sales promotion, and every other phase of merchandise work.

It is possible to exaggerate the importance of purchasing power in explaining the strength or advantages possessed by a retail store. Within limits, however, it is still true that large stores possess an advantage derived from their size and the fact that they purchase in larger quantities. Thus the manufacturers' selling costs per unit are less when they deal in large quantities. They are willing to quote lower unit prices for large orders. A manufacturer's salesman may consume no more of his time in taking an order for $1,000 worth of merchandise from a large store than in taking an order for $100 worth of merchandise from a small store. Packing and shipping expenses per unit handled are frequently lower. Office and clerical expense may not increase in direct relation to the increase in the size of the

[1] *Ibid.*, pp. 13–17.

order. By specializing on one type of merchandise, the independent store brings to the market an aggregate of buying power which gives it a pronounced advantage over the general store buying small amounts of many kinds of merchandise.

The larger sales volume secured from one type of merchandise also enables the store to carry more complete inventories. The specialized store is able to offer its customers a wider range of colors, sizes, styles, materials, and prices. By catering more successfully to the customers it serves, it can further enlarge its clientele, attracting new customers through its reputation of never failing to provide the merchandise desired. The smaller general store, buying in small lots and selling in small quantities, cannot profitably maintain an extensive inventory of each type of merchandise. It can satisfy only a few customers. But unless economies are secured from the other branches of store operation, it must sell at higher prices and offer a very limited selection of merchandise for customer choice.

Other advantages stem from specialization. The general-store operator, dealing in many types of merchandise, cannot acquire the knowledge of each kind possessed by the operator of the single-line store with respect to the particular type of merchandise in which he specializes. He cannot buy each type of merchandise so skillfully, nor can he direct its sale so effectively. His clerks suffer from nonspecialization in the same way. The single-line store operator, because he is a specialist, becomes, as his experience grows, increasingly expert in buying, selling, promoting, and directing the sale of the merchandise in which he specializes. He makes fewer mistakes. He merchandises more shrewdly. He sells more effectively. The general result is the presentation of newer, fresher merchandise in more attractive settings and frequently with lower costs of operation. More effective buying and lower costs of operation may combine to enable him to offer merchandise at lower prices.

It would be wrong to assume that single-line stores always undersell general stores. Many factors enter into the formation of retail prices. The mere fact that the general store is likely to be found in rural trading centers while the single-line store depends upon the larger traffic concentrations of urban centers may cause the specialized store to have higher costs of operation. Rents, salaries, advertising costs, and many other expenses are

higher in urban centers than in rural areas. It is still true, however, that because of its specialization, the single-line store may buy on better terms and may operate more effectively. Both factors exert a direct influence upon the prices of merchandise.

Factors Affecting Retailing in Rural Areas.—To secure a clear view of the position of the small retail store, it may be helpful to subject this type of outlet to a detailed analysis. We may begin with the small retail store located in a small town or rural area and proceed to small retail stores which are found in the large cities, trying to develop in the analysis an understanding of the competitive position of the small retail store, its advantages over other types of stores, its disadvantages, and the social and economic developments which have influenced its growth and have helped to shape its present position.

We have already described the operation of the country general store. With a small number of consumers to serve, stores in rural areas are forced to carry a variety of merchandise rather than depend upon a single type. As a result, the general store can seldom offer a large selection of goods from which customers may choose. It must carry a "hodgepodge" of everything. This does not mean that the country general store is necessarily an inefficient merchandising mechanism. On the contrary, it may be the most efficient means of serving a rural population. Its position has been weakened in recent years largely because of the development of better means of transportation from farming areas into the more important county towns or cities which serve as trading centers. Farmers drive into these centers for the majority of their purchases because in the larger and more specialized stores of the county seats they find a more adequate selection of merchandise, larger stocks, newer styles, and frequently more attractive surroundings in which to purchase. The country store is being forced to fall back upon convenience merchandise, goods which consumers wish to purchase in the easiest possible fashion and for which they are unwilling to travel any great distance. In serving customers with merchandise of this type the country general store is doing something which could not be done by any other type of store. In performing this service it may enjoy a number of advantages. It is usually free from the local competition of chain stores because the con-

suming area which the store taps is too small to support a chain store. In many cases it may hold a semimonopoly position, but only in the sale of convenience merchandise. Clothing and other types of shopping goods are usually not purchased in the country general store but in the specialized or department stores in the towns which serve as shopping centers for the surrounding rural areas.

Factors Affecting Retailing in Towns.—In these towns we find many types of small retail stores. The general store does not flourish here except in one form, the department store, which can really be viewed as an outgrowth of the general store. Like the general store, it carries under one roof all types of merchandise, but the merchandise is carefully divided into departments, and the sales volume of each department is usually large enough to support the carrying of adequate merchandise stocks. More frequently, however, in these small cities which serve as county seats, the small retail store is found to be a single-line store dealing in one type of merchandise. There are found the specialized grocery store, drugstore, clothing store, shoe store, and hardware store which are also found in the largest cities. These stores have certain advantages over the country general store. To a large extent the prosperity of the country general store depends upon the success of the local farmers with their crops. The fluctuation in business from year to year may be very large. There is a very close personal relationship between the storekeeper and his customers, and since buying on credit is the common method of purchase, this close personal relationship may hinder the storekeeper in the maintenance of a prudent credit policy. He may find it difficult to refuse to extend credit to a friend whom he has known for many years.

The store in the larger city operates with a much more impersonal relationship between the store manager and his customers. It is true that this relationship is closer than that which is found in the largest cities, but it still differs materially from that found in rural areas. In the county seat the independent store is somewhat relieved from the direct competition of the mail-order houses which sell the greater part of their merchandise in rural areas. In return for this relief, of course, the small retailers often face the competition of the chain stores as well as that of the retail stores maintained by the mail-order houses.

Because they have a larger volume of sales the small retail stores in the trading center towns are able to offer larger assortments of goods and many services to their customers. Their operating expenses are usually somewhat higher than are the expenses of operation of the country general store. They face more active competition from chain-store outlets. The weapons of competition, particularly in the form of advertising, are keener than in rural areas. Customers may expect more elaborate facilities within the store for displaying merchandise. The combination of higher rent locations with the greater expense of maintaining the elaborate interiors of city stores contribute to a higher expense of doing business.

Factors Affecting Retailing in Cities.—In the larger cities the same pattern of retail distribution is found. There are a few general stores; there are independent department stores; there are a great many small retail outlets, each specializing in the sale of one type of merchandise. Again competition is intensified and specialization is more complete. There may be specialization by type of merchandise carried, or specialization in range of prices or specialization in location (thus there are found specialty stores serving suburban shopping centers and other specialty stores in downtown locations), or even specialization by the type of service offered.

The independent single-line store usually has somewhat lower operating expenses than the department store but somewhat higher expenses than the competing chain store. The assortments of merchandise carried by the independent store are frequently wider than those found in the same departments in department stores. Despite the large size of department stores, therefore, the single-line store is usually at no disadvantage when purchasing merchandise, and as a result of its lower expenses it may have a substantial advantage over department stores in the sale of directly competitive merchandise. In addition, the single-line store benefits from the direct supervision of the owner. Customers usually appreciate their direct contacts with the owner of the establishment, and they have a much closer relationship with the single-line store than they usually have with the department store.

Compared with the chain store, on the other hand, the independent single-line store frequently offers many more services.

If it carries style merchandise, its goods can be more carefully chosen with the wants of regular customers directly in the mind of the buyer. These advantages may counterbalance the lower prices which the chain stores frequently are able to offer. The successfully managed independent single-line store seems to occupy a sound position, therefore, and appears to be in little danger of being crushed out between the competitive pincers of the department store and the chain store. In our major cities the single-line store has successfully sold convenience goods, shopping goods, and specialty goods. There is little in the experience of the past 10 years to indicate that the efficient independent retailer is in a seriously adverse competitive position or one which he will not be able to maintain in the future.

Major Operating Problems of the Small Retailer.—It is worth noticing that the competitive position of the small retailer does not depend solely upon differences in costs of operation and, therefore, in the prices at which merchandise can be sold. Costs do enter as an important consideration, but competition at the present time is being carried on along several fronts. There may be competition not only in price but also in merchandise carried, in store location, and in customer relations. The independent single-line store is at no major disadvantage on the basis of cost of operation and may be in a favorable position with regard to some of the other competitive devices which affect customer purchases. The selection of merchandise is usually made directly by the owner of the company. In the department store that selection must be entrusted to a buyer who cannot take the permanent personal interest in the business that will be devoted to it by the man who has invested his own money. The merchandise frequently is bought with the needs of particular customers directly in the mind of the buyer. The services which are offered may be developed with the specific desires of the store's customers in mind, and, in the smaller store, customer relations can be placed on a much closer personal basis than they can in either the department store or the chain store.

Personal Supervision in Small Stores.—If any single factor can be said to lie at the heart of the operating problem connected with small retail stores, it is the personal supervision of the owner. The man who risks his funds in the enterprise is usually the man who manages the store. That personal supervision makes itself

felt not only in the field of customer relations, but throughout every phase of store operation. It influences buying and selling. It may be the crucial factor determining the success of the manager's efforts to compete with other and larger retail outlets and with chain stores. It may direct and mold the loyalty and service of the selling staff. It may be responsible for the position of the store in the community. Indirectly, it has influenced recent legislation directed primarily against large-scale retail outlets.

Problems of Merchandising Small Stores.—It is significant that the problems of small-store management are to a large extent the problems of large-store management. The merchant, whatever the size of the store he directs, must buy merchandise. That buying process involves an interpretation of consumer demand and preference for styles, prices, materials, colors, and many other variations in customer wants. The buying process also involves an examination of the market, the offerings of manufacturers and wholesalers, trends of prices, and potential style developments which may in turn affect consumer demand. When the merchandise has been purchased, it is shipped to the store. There other problems arise, connected with the operations of receiving and marking the incoming goods. What retail prices shall be placed on the merchandise? Over his season's operations the merchant must secure prices high enough to repay him for the original cost of the merchandise sold and, in addition, all the costs of operating his store, while, at the same time, securing for himself a profit.

When the merchandise has been marked, it must be brought on the selling floor and an entire new series of operating problems must be solved. The merchant must make decisions with respect to display, to the use of window space to show the goods, to the use of advertising. He must instruct his salespeople in the attractions and advantages of the new merchandise. He may be called upon to assist in selling. At the same time, his attention must also be directed to clerical and bookkeeping duties which arise in connection with handling merchandise and money. When the sale has been completed, problems connected with delivering the merchandise may arise or, possibly, others connected with the granting and supervision of installment credit.

The Competitive Position of the Small Store.—All these operations are directly connected with the expense of doing business. All of them are carried on in stores both large and small. The comparison of the expense of operation in stores of different size, in independent stores and in chain stores, in city stores and in suburban stores, is of great significance in determining the competitive position of stores of various types selling the same or similar merchandise. The combination of the cost of goods purchased and the cost of doing business must determine, for any store, the average prices at which it can sell its merchandise.

Selling price alone does not determine whether a prospective customer will buy in one store rather than another. There are chain grocery stores which sell nationally advertised brands at low prices and, in the same community, small independent grocery stores which may sell the same advertised brands at higher prices. Yet the independent grocers remain in business. Some people continue to purchase in these stores. Why? Surely not in every case because the customers are unaware of the difference in prices; rather, perhaps, because the independent stores may offer services not available in chain stores. They may extend credit and make deliveries, while the chain stores do not. Customers may feel that the owners who are in the stores will give them better merchandise or better service. The independent stores may have more convenient locations. They may retain customers through habit or loyalty. Price alone does not determine where people purchase. But price is important. If the difference between chain grocery prices and independent grocery prices in a community becomes very marked, customers will shift their purchasing to chain stores. The greater the potential savings in chain stores, the more customers will transfer their purchases. It becomes apparent, therefore, that there are many people who are willing to pay extra for certain services and conveniences.

Much of the feeling against chain stores has arisen because of the belief that chain stores undersell independent stores and that much of their ability to undersell rests upon price concessions secured through large-scale purchasing. Many authorities have challenged this conception of the competitive status of chains and independents. They have asserted that the effi-

cient independent operator has nothing to fear from chain stores. By joining other independent stores in voluntary buying associations, he may purchase on terms as favorable as those offered to chain stores. Many manufacturers, indeed, are recognizing that chain stores, with their private-brand merchandise, are not the best outlets for manufacturers' brands. These manufacturers are seeking to strengthen the independent outlets and aid them by offering favorable purchasing terms.

The experience of efficient independent outlets seems to support this view. More successful merchandising methods and store-management techniques have been introduced by the chain stores. But most of these innovations may be adapted to independent-store operation. The one consideration which favors the chain-store organization is that, because of its large sales volume, it can group a number of executive tasks and employ a skillful person to administer them. The independent store, with its small volume, cannot afford to employ a man of equal skill. To balance this advantage, however, there are the beneficial results derived from the close daily contact of the owner with his business which can be secured only in the small independent store. The division of labor and delegation of tasks to subordinates, necessary in the chain organization and in many instances productive of economies, carries with it the danger of indifference to details and close adherence to routine. There is good reason to believe that these are major disadvantages in retail-store operation.

The inefficient independent has been competing with the chain stores under very difficult conditions. He sees his customers transferring their trade to chain stores where they secure lower prices, better service, and more attractive stores and merchandise. He believes that lower prices stem from chain-store operation and not from more efficient operation. He raises the claims that chain stores are alien to the local community, that they take money out of town, that they are unfair to their employees and to their customers. He leads the agitation for punitive taxation directed against the chain stores.

It is questionable whether action of this character will lead to a solution of the difficulties experienced by small retailers. So far as legislative action is concerned, the ultimate decision may rest, not with the independent outlets, but with the great

body of consumers whose real purchasing power is directly affected by changes in retail prices. A sounder solution would appear to lie in the direction of voluntary cooperation among small retailers to secure the benefits of large-scale operation. A solution of this type would rest its strength on the solid and recognized advantages of small retailing. It would encourage competition rather than shackle it.

CHAPTER IX

LARGE-SCALE RETAILING

"A wave of giantism has been sweeping over American business. There is no excuse for the blind acceptance of the statement that large organizations are better organizations. Often they are worse, less flexible, less efficient, more costly. This has been particularly true in marketing, where the lessons of production have been misinterpreted and misapplied."

"Can any of us measure the price of being sentimental over the preservation, by legal force, of inefficient, out-dated small business? If the chain store is a better store than the independent store, why handicap it by charging the consumer a fee for preserving small business? Fee it surely is, paid in the form of higher prices."

Development of Large-scale Retailing.—"One end of the marketing process lies at the farm, the forest, the mine, and the factory; the other lies at the retail store across the counters of which pass the streams of merchandise purchased by consumers." As our economic society has become more mature, larger organizations have developed in business. Production moved into an era of giantism before marketing. Long before the first large department store or the first chain-store organization appeared, factories of considerable size were in operation. The movement occurred in the field of factory production because of the development of machinery and the possibility of using it most efficiently on a large scale. Even at the present day the use of machines in retailing is still limited. The development of what we have come to call large-scale retailing—the city department store and the chain-store organizations—has rested on advantages other than those secured through the replacement of humans by machines.[1] Economies in buying, more efficient management secured through specialization and training, and the combination of wholesale and retail functions have all been present as forces leading retailing into combinations and growth.

Part of the growth, doubtless, has been unsound. The opponents of giantism in marketing have been exploring every

[1] McDermott, L. M., Why People Buy at Department Stores, *The Journal of Marketing*, 1936, p. 53.

weakness in large-scale retailing. Statistical surveys have shown in many areas distinct evidence of a tendency toward higher costs of operation among larger stores. Critics have pointed out that large department stores may be unwieldy. They indicate that the claim of mass buying power may be a delusion, since, although the store as a whole is large, its many individual departments may be smaller than the competing independent specialty stores. Commentators on chain-store merchandising have stated that chains can grow so large that the multiplicity of operating problems which they present surpasses the executive ability of their officers. Beyond constructive criticism of this type there has been for many years the steady opposition of small independent business protesting the encroachments of "big business." Much of this opposition may be unreasoning, or based upon the claims of the less efficient operators. It has been effective, however, in securing the passage of legislation designed to circumscribe, limit, and regulate the operations of large-scale retail outlets.

What are these large-scale outlets which have been the center of so much discussion in recent years? Careful examination of their organizations, detailed study of their operations, may throw some light upon the reasons for their existence and for the opposition to many of their practices. It is impossible to understand the bitter antichain-store movement or to evaluate the justice of its charges without first understanding what the chain store is and how it works. It is as difficult to measure the force of competition between department store and specialty store without first understanding how a department store is organized and how it operates. Let us begin with that typical retail outlet in our larger cities, the full-grown department store.

THE DEPARTMENT STORE

Characteristics.—Described in the simplest terms, the modern department store[1] is the old country general store grown up.

[1] Barker, C. W., and I. D. Anderson, "Principles of Retailing," p. 17, McGraw-Hill Book Company, Inc., 1935. "A department store is one, usually with a large annual volume of sales, handling a wide variety of merchandise including dry goods and women's ready-to-wear, arranged into departments, each of which is merchandised separately as to location, personnel and records."

It is grown up because it serves, not the scattered population around a rural trading center, but the masses of people in our large cities centering their purchases in the congested principal retail shopping areas. It is grown up because it is divided into distinct departments, each specializing in the sale of one type of merchandise. It is grown up because, as a result of the size of its operations, it employs skilled executives. It is grown up because it is strong financially, because it offers many services, because it provides elaborate shopping facilities, because it sells merchandise which may come from distant countries; but it is still an elaborate reproduction of the country general store selling every type of merchandise under a single roof.

The department store is a women's store. It had its beginnings in the nineteenth century dry-goods store. It developed as a result of the traffic and consumer concentration found in the larger cities. It has promoted fashions and has specialized in the sale of shopping goods. And it has always remained primarily a women's store. Its merchandise departments have directed their attention toward women shoppers. Its advertising has appealed principally to women. Its services have been those desired by women customers. Its interior display has been designed for women's tastes. The sale of men's merchandise is usually confined to a few departments, and these departments have frequently been located in a separate section of the store or in a separate building.

The department store is a large store. Selling shopping goods, it must be located in the main shopping area where mass traffic concentrates. It is an important purchaser of newspaper space to carry its advertising messages. Its windows are devoted to attractive displays of merchandise, and they are important advertising media because they face crowded sidewalks. It devotes care to planning interior layouts and departmental displays. It seeks to make shopping as easy and as pleasant as possible. Its salespeople are trained for their tasks. It must support an elaborate organization behind the scenes, employed at the multitude of nonselling tasks which are necessary to successful department-store operation. In the larger department store, division of labor and specialization may be extended throughout a large part of the organization. As a result of all these factors, the typical department

store is a high-cost retail outlet. Despite its large purchasing power, its costs of operation are likely to be higher than the costs of operating a chain-store unit or a small independent specialty store.

Meeting Present-day Problems.—The department store grew with the growth of our large cities. Now that certain changes seem to be occurring in the formation of cities, movements toward decentralization, toward the growth of suburban shopping centers; now, too, when the uninterrupted prosperity of the 1920's has slackened, the department store has been finding operating problems more difficult. In recent years the line of profits has turned downward. There seems to be a tendency for consumers to transfer purchases to other types of retail outlets, either to those selling at lower prices because of lower costs of operation, or to those selling style merchandise on a more attractive and personal basis. Trying to meet these new conditions, many stores have initiated changes. They have opened suburban branches to tap the trade now drawn to the outlying shopping centers. They have opened bargain basements featuring inexpensive merchandise. They have joined in ownership groups in the effort to reduce expenses and secure the benefits of more skillful management. They have joined in cooperative buying procedures designed to promote further economies in buying or to secure better merchandise and departmental direction.

It is possible that the years ahead may see radical changes in the organization and structure of department stores as they endeavor to adapt themselves to new conditions and new buying habits.[1] Like every other type of marketing institution, they are shaped by the consumer demand they are trying to serve. Those institutions which best adapt themselves to the nature of that demand, those which offer goods and services corresponding most closely to the demands of consumers are the ones which secure the greatest volume of trade and the largest profits. We may examine the organization of department stores at the present, however, knowing that they represent a type of retail institution which has developed in response to the nature of consumer demand in large cities since the late nineteenth century,

[1] Filene, E. A., W. K. Gabler, and P. S. Brown, "Next Steps Forward in Retailing," Edward A. Filene, Boston, 1937.

a type of retail institution which is still serving the mass desires of consumers for shopping goods.

Department-store Organization.—The basis of department store organization[1] is the division of the store into distinct departments each selling one specialized type of merchandise, managed separately, and usually controlled by distinct departmental accounting methods so that a net profit or loss can be determined for each department. The departments are almost separate shops within the large store, backed by central financing, under the direction and guidance of a unified central management, and supported by the strength of the single store's established name and reputation.

The numerous nonselling activities which are essential to the successful operation of a department store have led to a division of store management into a number of broad functions. The typical large department store is organized in four divisions: one dealing with problems of merchandising; a second with problems of advertising and sales promotion; a third with problems of store management, personnel, and store housekeeping; and a fourth with problems of accounting and finance. The heads of the four divisions may, with the president, make up the management committee. Reporting to the merchandise manager who directs the merchandising division are the divisional merchandise managers who in turn direct the buyers. Usually there is a buyer for each selling department. Under the buyer may be an assistant buyer, a merchandise clerk or head of stock, and the department's sales force. Under the advertising manager are found the copy writers and artists engaged in preparing promotional material for all the advertising used by the store, covering such diverse media as newspapers, direct mail, radio, window displays, and interior store displays. Under the store manager are found the executives and employees directing personnel, traffic management, delivery, and all the housekeeping functions which are needed to keep the store and its merchandise clean, safe, and serviceable to consumers. Under the treasurer will be found junior executives and a staff directing the complex tasks of accounting and bookkeeping.

[1] Mazur, P. M., "Principles of Organization Applied to Modern Retailing," Harper & Brothers, 1927.

The four-legged organization is not found in every large department store. It is perhaps the most widely used. But many stores combine advertising and merchandising under a single head and have a three-divisional organization. Others combine store management and accounting as well and work with only two major divisions. Some stores give more prominence to the personnel function and operate with five or six major divisions. In practically every store, however, it has been found desirable to specialize by major operating functions. Whatever the organization may be, the functions and activities are the very ones necessary to the operation of a small retail store. In the small store the proprietor alone may buy and sell, prepare his own advertising, do his own housekeeping and accounting. There are no new functions in large-store operation. The increased volume of operations makes specialization desirable, but the elaborate department-store organization is disclosed on careful examination to be a replica of small-store organization blown up to giant size. The advantages and disadvantages of department stores, compared with other types of retail stores, do not lie in the performance of new functions or in the omission of certain operations found in small stores. They are derived from the efficiencies and the inefficiencies which are connected with comparative size and with more or less complex organizations.

Basement Stores.—Attempting to secure the maximum sales volume from available store space, many department stores have opened basement stores. In most cases these stores have sold in their basements complete lines of all types of merchandise, but at prices lower than those prevailing in the main stores. A few stores have operated their basement departments as job-lot stores, selling distress stocks of manufacturers, stocks of bankrupt stores, and all kinds of odd lots of merchandise which can be secured at unusually low prices. In basements of this type, the customer cannot always be sure of finding the exact item she wants in her size, but she is certain to find, from time to time, unusual bargains.

Leased Departments.[1]—A number of department stores make a practice of leasing one or more departments to outside operators who pay either a fixed sum or a proportion of sales as rent.

[1] Teele, S. F., "Department Leasing in Department Stores," Harvard Bureau of Business Research, 1933.

Leasing is commonly resorted to when store executives believe that a department can be operated to better advantage by an outside organization specializing in that type of merchandise. Frequently this situation arises when the volume of sales secured in the department in the store is so small that it would be unprofitable to employ a skilled buyer to direct the department. At times it may be the result of special operating problems arising in connection with merchandise particularly difficult to handle. Millinery, with its extraordinarily rapid change in style popularity, has proved unusually difficult for department stores to sell at a profit, and many stores have leased their millinery departments to organizations specializing in such merchandise. These organizations are frequently operated as chains, leasing similar departments in a number of stores and managing them from a central office.

The greatest danger in leasing to an outside organization is failure on the part of that organization to manage the department in such a way as to maintain and enhance the reputation of the store as a whole. Shoddy merchandise, unfair prices, or poor salesmanship in a single department may endanger the good name of the store. Elaborate contractual terms are frequently devised, designed to control these aspects of the outward relation of the lessee to the public. The dangers present in this situation have prevented a number of department-store operators from entering into lease arrangements for unsatisfactory departments. They have often preferred to continue to operate losing departments themselves, rather than entrust the established reputation of their stores to outside interests.

Branch Stores.—One of the most interesting developments in department-store operation in recent years has been the opening of branch stores. The practice has arisen as a result of the development of transportation facilities in the larger cities. The congestion within the central metropolitan areas and the availability of swift comfortable transportation led to the movement of large numbers of people toward suburban areas. Here, at the intersection of main traffic arteries, with ample parking space for cars, small shopping centers began to grow up. Traffic increased, and real-estate values rose. Variety and grocery chains saw the opportunity to solicit trade on the basis of convenience in purchasing. Their presence drew consumer trade.

Small independent specialty shops were opened. Gradually many department-store operators noticed a tendency for some of their customers to transfer their trade to these suburban shopping centers. The inconvenience of traveling to the center of the city to make a purchase and the parking difficulty began to outweigh the established attractions of the large downtown department stores.

A number of department stores in different parts of the country have attempted to regain the lost trade and attract new business by opening branches in the growing suburban shopping centers. They have not had uniform success, but the growing number of branch stores testifies to the belief of many retailers that this development represents a worth-while venture. The branches are necessarily smaller than the main stores. Their stocks of merchandise cannot be so complete. Nor can they sell with success merchandise of the shopping-goods type. But such merchandise as children's wear, women's sports clothes, accessories of all types, and inexpensive dresses have been sold in volume at suburban branches. Certain stores which have firmly established reputations either as the finest exclusive outlets for expensive stylish merchandise or as extremely low-price outlets for bargain merchandise seem to have been successful in selling at suburban branches practically all types of merchandise. They have not been handicapped by the difficulties of selling shopping goods under nonshopping conditions. The apparent tendency to continue the decentralization movement in our larger cities appears to favor the further development of the branch-store system. The technique of administering branch stores is still in a rudimentary state. Many stores have found management problems to be paramount and no uniform method of administration has been devised which seems universally applicable.

High Cost of Operation.—The modern department store attracts customers through the variety of merchandise it offers, the ease and pleasure of shopping in attractive surroundings and of being able to complete purchases without leaving the store, and the number of services which are available. Its size and position in the community strengthen its reputation. Customers learn to rely on its name and to trust its merchandise. They use and enjoy its varied services which may include free delivery, extension of credit, return privileges, rest rooms, personal shop-

ping bureaus, style and fashion advisory service, and interior decorating service. Because of its location in the heart of the urban business section where rents are high, the multitude of services which it offers, its attractive interior, and its extensive advertising, the cost of operating a department store is rather high. On the other hand, large purchases, often secured through cooperation with other department stores in group-buying operations, assist in lowering the cost of merchandise. This counteracts, to some extent, the high expense rate.

The department store remains, however, one of the higher cost retail outlets. For this reason it has been especially vulnerable to competition from other types of retail stores with lower expense rates. The variety chain stores, specialty stores, and, in some cases, low-price department stores, serving customers with a minimum of services, in less attractive surroundings, and frequently in low-rent locations out of the main shopping areas, have been drawing trade from the department store. They have attracted customers through appeals directed to the desire to economize. They have been particularly effective in periods of depression. But the experience of recent years seems to indicate that their appeal is not confined to such periods. Rather it seems that at all times there is a substantial body of consumers willing to sacrifice certain services and some convenience in purchasing in order to secure merchandise at lower prices.

This does not mean that department stores are doomed to decline in importance as retail outlets. It does mean that they will not serve as major purchasing centers for consumers in all income groups. The success of stores with lower expenses of operation has been a matter of concern to department-store operators. Discussion has centered for many years around ways and means of reducing expenses of operation and a number of proposals have been made relative to eliminating costly free services, simplifying organizations, or revising management and ownership structures. Some ventures have already been made along these lines. It has been predicted that the department store of the future may differ markedly from the retail store as we now know it.

Tendency toward Centralized Control.—A number of independent department stores have combined into ownership

groups,[1] stores operating under single financial control but usually with independent merchandising management. Groups of this type have frequently been an outgrowth of the common use of a New York buying office by a number of stores in different cities. Ownership groups have experimented with group buying, whereby the buyers for one department in the several stores make purchases together, thus securing increased advantages from their tremendous quantity buying. Department-store chains[2] have been organized as a step beyond the ownership groups. In the chains, merchandising and store management have been largely centralized. One buyer in the central office of a department-store chain, for example, may purchase men's shoes for the men's shoe departments in all the stores in the chain.

This type of organizational development represents a major change from the typical department-store structure. It bears a close resemblance to the kind of organization found in the retail stores maintained by the large mail-order companies and to the organizations of the variety chain stores. The limited experience available indicates that the department-store chains have lower costs of operation than have the independent depart-

[1] Teele, S. F., Operating Results of Department Store Chains and Department Store Ownership Groups: 1929, 1931–1934, *Harvard University Graduate School of Business Administration, Bureau of Business Research, Bulletin* 101, p. 7, states: "The term 'department store ownership groups' has been adopted for combinations of department stores under a single ownership. . . . In spite of some interchange of operating figures, some attempts at group and central buying, and financial management by the parent company, the stores of most of these groups continue to be operated primarily as independent units under central ownership."

[2] Teele, *op. cit.*, p. 7. "As commonly used, the term 'department store chain' describes a great variety of companies, ranging from the J. C. Penney Co., on the one hand, to Federated Department Stores, Inc., on the other. . . . The Bureau uses the term to describe concerns having a substantial measure of centralized buying and control, dealing in a wide range of general merchandise, having at least rudimentary departmental organization within the individual units, and operating without such price limits as characterize the variety chains. . . . A further distinguishing characteristic of the concerns included in the department store chain category is that the merchandising emphasis is not placed on fashionable wearing apparel to the extent that it is in typical department stores. Finally, chain department stores do not provide for customers all the services commonly given by typical department stores."

ment stores or the ownership groups. Much of the expensive superstructure of executives in individual stores can be done away with. More skillful executives can be employed at the central headquarters who extend their services to all stores in the chain. Standardization of procedures may effect further economies. Routine operation may be simplified. There is some reason to believe that the future may see a wide extension of this type of organization, at least among department stores selling at medium and low prices. The case of department stores selling luxury merchandise at high prices to the upper income classes may be different. Here price is only a minor consideration affecting purchase. Individuality of merchandise and service may seem more important to customers. Where this is true, the chain type of ownership and management has little to offer.

Cost Cycle in Retailing.—In a significant way, costs of operation lie at the heart of the department-store operating problem. This is true despite the fact that competition has been extended to other fronts. Competition has taken place on the basis of the number and kind of services offered by different stores. It has been particularly strong on the basis of comparative advertising. It has been experienced in the case of store location sites. Yet the problem continually reduces itself to the single focus of costs of operation. For costs of operation, more than any other single factor, underlie selling prices.

Observers of the course of retail history have called attention to what appears to be a well-defined cost cycle.[1] There seems to be a tendency for the costs of operation of any type of retail store to experience a steady continuous rise. When a new type of retail store is developed, its costs of operation tend to be low, and it attracts customers largely through its low prices. As time passes, a number of factors contribute to rising costs of operation. The stores may move into heavy-traffic high-rent areas. The operators may improve the appearance of their shops. More services are offered to customers. Competition tends to shift away from price and toward service. This has been the history of the department store. For this type of retail

[1] This observation is developed at length in M. P. McNair, C. I. Gragg, and S. F. Teele, "Problems in Retailing," pp. 17–22, McGraw-Hill Book Company, Inc., 1937.

store, average cost figures have been rising steadily. It has also been the history of the chain store. Variety chains have experienced the pressure toward higher costs of operation. Grocery chains have moved from low to higher costs of operation. As this cycle of higher costs develops, new types of retail outlets may enter the competitive field, selling the same merchandise at lower prices, able to do this because they enter with lower costs of operation.

The most recent example of the operation of the cost cycle has occurred with the rise of the supermarket[1] in the grocery field. Supermarkets, entering the retail field about 1931, undersold even the grocery chains. They were located in unused factories and garages where rents were extremely low. They offered customers merchandise with an absolute minimum of services. It is interesting to observe that even in the few years during which supermarkets have been in operation, there appears to be a tendency for their costs of operation to rise. The appearance of these stores is being improved. Sites in high-rent areas have been utilized. Costs must move upward, and with rising costs the comparative price advantage which first attracted large masses of consumers must diminish.

Reasons for High Cost of Operation.—While expenses of operating department stores have been rising, gross margin, the other vital operating figure, has not been increasing at the same rate.[2] To increase gross margin stores must secure merchandise at lower prices or succeed in raising retail prices. Apparently department stores have gone about as far as possible in both directions. Lower merchandise costs have been sought through mass buying power; the extension of the department-store chain may make possible certain further economies in this direction. Higher retail prices will, of course, weaken the competitive position of the department stores and attract more patrons to other types of retail outlets with lower costs of operation and lower prices.

[1] Phillips, C. F., The Supermarket, *Harvard Business Review*, 1938, p. 188.

[2] Gross margin is the difference between cost of merchandise and its selling price. For a store as a whole it is the difference between total cost of merchandise and total net sales. Gross margin, then, provides for a store the fund out of which it pays all operating expenses. The amount by which gross margin exceeds expenses of operation constitutes the profit.

To clarify this reasoning, it may be well to summarize at this point the factors in department-store operation which contribute to the high expense rate. Department stores offer a variety of elaborate services. They are located in high-rent districts. They spend large sums for advertising. They sell style merchandise which has a rapid rate of obsolescence. The risks in handling merchandise of this type are very great. Substantial markdowns may be necessary to sell merchandise when it does not prove immediately popular. Department stores have elaborate supervisory and executive control organizations. They have found it desirable to spend large sums to make both the exteriors and the interiors of their buildings more attractive. They employ more skillful salespersons than do most other types of stores, a desirable practice in selling merchandise of the type commonly carried in department stores. One more consideration which is sometimes overlooked is the inflexibility of the typical department-store organization. Business does not continue at the same rate month after month and year after year. Yet, once established, the typical department store must continue with its existing organization without contracting and expanding in proportion to the trend of sales. Some variation in the selling force may be made, but experienced and valuable executives cannot be discharged in times of slack business. They will transfer their services to other stores and their positions will have to be filled by new and untried workers. The expense of employing and training new workers is not the least of the elements contributing to the high expense rate of department stores.

Some Problems of Department-store Management.—A number of special problems of department-store management which bear some relation to the expense rate should be mentioned. One of these is the problem of handling returned merchandise. Merchandise returns contribute to higher expenses in many ways. They increase merchandise handling and delivery costs. They increase markdowns. They waste the time of salesclerks. Merchandise returns have always been heavy in the field of style merchandise, and department stores have been particularly vulnerable. The general policy of "the customer is always right" has contributed to the difficulty. Attempts to restrict the return privilege have not been uniformly successful. As long as some stores offer unrestricted return privileges as a

competitive service, those stores which attempt restriction in self-defense will necessarily lose trade. Investigations have demonstrated that a portion of the returns can be traced to defective or wrongly sized merchandise. Among the practical steps which have been taken to control the menace of returned goods, the following may be noted: the adoption by all stores in the community of uniform rules governing the acceptance of returned merchandise; cooperation with manufacturers to control accurate sizing and truthful statements of merchandise contents and construction; better training of the sales force; and general cooperative advertising to consumers designed to extend education regarding the evils of unrestricted returns and the contribution they make to higher prices. Despite the efforts which stores have made in the past to control the reckless use of the return privilege, the proportion of merchandise returns in department stores is still extremely high.

Another special problem of department-store management which bears a close relation to the expense of operation is that which deals with the selection, training, control, compensation, and advancement of store personnel. This difficulty is not confined to the employees directly engaged in selling. In the larger department stores more than 50 per cent of the employees are engaged in nonselling activities, and their work is vital to the successful operation of the store. Particularly in recent years, the personnel divisions of department stores have expanded the range of their work to include, not merely hiring and firing, but placement, training, supervision, compensation, and welfare. Increasingly have department-store operators become conscious of the importance of their sales force and its skill. They have realized that efficient buying and expert store management may be nullified by ineffective selling. They know that a well-trained, intelligent, and courteous sales force is the mark of a successful store and that such a sales force is not developed by chance.

A third major problem of department-store management which is closely related to the expense rate is the handling of markdowns. As leaders in the promotion of new styles in all types of merchandise, department stores have long been troubled by the high rate of markdowns which inevitably follows mistakes in forecasting trends in consumer demand. A high rate of mark-

downs is a certain cause of serious loss. Adequate control over the percentage of returned merchandise may contribute to lowering a store's rate of markdowns. More effective may be the elaborate merchandise control systems which have been devised to aid in following with the greatest accuracy all movements of merchandise into and out of the store, and in recording variations in consumer demand as made evident by purchases of merchandise and requests for merchandise not carried in stock. Only by careful control and skillful buying can department stores, with their extremely complex inventory problems, hope to maintain adequate and sufficiently varied merchandise stocks without burdening their shelves with merchandise mistakes, slow-moving goods, wrong styles, wrong colors, wrong materials, and wrong sizes.

Mail-order Department Stores.—The work of the mail-order houses selling direct to consumers has already been discussed.[1] In recent years Sears, Roebuck and Co. and Montgomery Ward and Company, two of the leading mail-order concerns, have entered the retail-store business. Their retail stores have been organized as department-store chains, centrally managed and with central buying. The manager of a mail-order retail store must necessarily be given greater latitude of authority and responsibility than the manager of a small variety chain store. But even in these department-store chains, the manager's authority is carefully circumscribed and he reports continually to central headquarters. He may select the merchandise his store will carry, but he makes his selection from lists of merchandise submitted to him by the central buying staff.

With carefully developed skeleton organizations in the individual stores and central management extending its counsel and authority throughout the chain, costs of operation have been markedly lower than in independent department stores. Mass buying power for combined mail-order and retail organizations and the development of brands owned and sold only in the mail-order and retail organizations have also aided in reducing merchandise costs.[2] As a result, the retail stores of the mail-order concerns have been strong competitors of all types of retail

[1] See Chap. VII of this text.

[2] Thomas, J. F., Varying Functions in Distribution, Their Costs and Influence on Retail Prices, *The Journal of Marketing*, July, 1938, p. 47. See "Example B."

institutions. They have been particularly successful in the sale of automobile supplies, hardware, and such "hard" lines of merchandise as refrigerators, stoves, and kitchen equipment.

THE CHAIN STORE[1]

Definition.—A chain-store organization has been defined by the Federal Trade Commission as being two or more establishments operating under common management, ownership, or ultimate capital control, engaged in the sale of goods, wares, or merchandise.[2] The definition is broad enough to cover every variety of chain[3] selling all types of merchandise and ranging in size from a two-store organization to such a giant of modern merchandising as the Great Atlantic and Pacific Tea Company operating thousands of stores in every part of the country.

Reasons for Growth.—The chain store is one of the recent innovations in retailing.[4] The important rise in this type of distributive outlet occurred after 1920. At the present time, although hampered by criticism and attacked on a broad front, they occupy important, if not dominant, positions in the sale of many kinds of merchandise. The growth of chain-store organizations has been assisted by the increasing size of our cities.[5] In the larger cities it becomes highly profitable to utilize a single warehouse to service a number of small retail stores. Central management controls unit stores more easily when they are closely grouped. They have been aided by the inefficiency of numerous small independent retailers who by their slovenly

[1] The Federal Trade Commission's "Chain Store Investigation" gives in a series of pamphlets a thorough going study of the chain store. One of these, The Final Report, summarizes the investigation.

[2] Barker and Anderson, *op. cit.*, p. 26. "A chain is a group of stores handling similar merchandise, under central management and ownership, and merchandised from a separate central office."

[3] Chains may be classified according to the (1) type of merchandise carried (grocery chains, variety chains, etc.), (2) extent of territory served by chain (local, sectional, and national chains), and (3) ownership (independent, manufacturer's, wholesaler's, mail-order house, department store, and utility operated).

[4] Beckman, T. N., and H. C. Nolen, "The Chain Store Problem," McGraw-Hill Book Company, Inc., 1938. Chapter II discusses The Origin and Growth of Chain Stores.

[5] Most chains had their origin in cities. Even today the chain store is largely an urban institution. In the cities it accounts for a much greater proportion of business than it does in the towns.

storekeeping methods have made the service, merchandise, and appearance of chain stores more attractive to consumers. They have been aided by their economies in operating costs[1] and the benefits of large-scale buying,[2] both contributing to lower retail prices. Such considerations as the elimination of services (credit and free delivery), standardization of store operations, stocking only fast-selling items, promotion of private-brand merchandise, integration of wholesale and retail activities, and many others have been important factors influencing the rise of the chain store in the pattern of retail distribution.

In appraising the competitive position of chain stores, it is desirable to understand that their success has not rested solely on the sale of merchandise at lower prices. In large part, of course, they have been successful for just this reason. But they have also brought to consumers more and better merchandise. They have been leaders in the modern packaging development. They have introduced new techniques of store management and division of labor, many of which have been adapted by independent stores. They have been partly responsible for the improvement in retail practice which has occurred in recent years. They have adapted mass promotion and mass selling to the disposal of surplus supplies of a number of farm[3] and manufactured products. They have studied buying habits carefully and have evolved new ways of improving customer service and easing buying difficulties.

Their success has not rested on price appeal alone.[4] To be sure, their costs of operation have been lower than operating

[1] Beckman and Nolen, *op. cit.*, pp. 48–53, 143–146.

[2] *Ibid.*, pp. 43–48.

[3] "National Apple a Day Sale," National Association of Food Chains, 1938.

[4] Beckman and Nolen, *op. cit.*, p. 171. "Florida consumers are attracted to chain grocery stores by appeals other than price, the three most powerful incentives in addition to lower price being wider selection of goods, convenient store location, and better quality of the merchandise."

Holsinger, Zelda, Attitudes of Women toward Types of Stores, *The Journal of Retailing*, December, 1938, p. 104. "Women gave as their reasons for buying food in stores that are units of chains the following: economy, quality of merchandise, and convenience. Unfavorable reactions to buying food in chain stores are limited services and high prices.

"Good service, convenience, and quality of merchandise are reasons given for buying food in stores that are independent. Unfavorable reactions to buying food in independents are indifferent salespeople and high prices."

costs in the independent stores with which they have competed. But they have been better merchants than the poorer class of independent storekeeper. Not only have they bought for less and sold for less; they have improved merchandise, sponsored better standards, offered new styles and more complete stocks. This background of better merchandising practice has supported their primary attraction of lower prices.

Organization of Chain Stores.—Like other large-scale businesses, chain stores rely on division of labor and elaborate organization. The division of responsibility frequently follows the same general lines found in department stores. Because of the complexity of real-estate supervision, a separate officer may be detailed to devote his entire attention to that problem. Other important functions may be placed under specialized executives. But whatever the organization may be in any chain, the distinguishing feature is always centralized management. The central office buys for the chain. The central office plans advertising. The central office evolves the personnel policy. The central office manages real estate, decides when and where to open new stores, when to close old ones. The central office plans the accounting procedure and the forms to be used and determines the frequency with which uniform reports are filed by store managers. The duties of the store managers are largely routine. They follow orders with little or no freedom to act contrary to or beyond the instructions received from their superiors. There may be in the larger chains a group of intermediary field supervisors whose duties include a general checkup on the activities of the store managers, but this in no way changes the picture of centralized management controlling all operations.

Such elaborate division of labor for a large chain may lead to a number of benefits. Skilled executives can be employed at high salaries to occupy the important central positions. They can direct their specialized functions more efficiently and through their orders the stores can be managed more efficiently than if each store manager had to deal with the multitude of problems which face the manager of the independent store. Store managers with circumscribed duties may be employed at lower salaries, and the efficiency of the entire organization may be improved while the costs of operation are lowered.

It should not be supposed, however, that the elaborate organizations supported by the various chain-store companies yield

unmixed benefits. The further management is removed from actual store operation, the more difficult it becomes to guarantee effective store operation. There are difficulties of operation and management found in chain-store organizations which are not present in independent-store operation. These include problems of effective administration and supervision of personnel and of adjustment to local conditions and problems arising from the magnitude of chain-store operation. These difficulties have hampered the chains in their expansion. They have been of paramount importance in protecting the competitive position of the efficient well-managed independent stores.

Personnel Problems.—Many of the problems of chain-store operation center around personnel difficulties. It is an old saw, but a true one, that no outsider takes the close interest in a business displayed by the man who owns the business. The separation of ownership from detailed store management in the chain-store business,[1] despite the fact that it enables the chains to secure more experienced and skilled executives and lower costs of operation, has raised serious problems only a few of which have been successfully solved. Store managers with salary and commission compensation have not always been perfect store managers. When the dollars which slip out are not their dollars, they are not so closely watched. Even the most able management in a central office may not be sufficiently alert to local conditions. General orders affecting the entire chain may be ruinous for one or more stores which face unique local difficulties.

The chains may become so large that no executives, however skilled, can successfully administer them. Large organizations are often inflexible. They are encumbered by red tape and routine operations. They do not respond quickly to changes in competitive conditions. They may be expensive at certain periods when sales decline. As in factory operation, specialized workers are efficient employees only when they can be continually occupied with their specialized tasks. If the flow of work slackens, they are idle and consume time and salary without returning work for value received. With the ebb and flow of retail sales, such slack periods are often experienced by chain-

[1] J. C. Penney Company has tried to avoid this evil by giving each manager of a store part ownership in that store. See R. W. Bruère, "J. C. Penney, the Man with a Thousand Partners," Harper & Brothers, 1931.

store companies. At these times their highly efficient organizations may become expensive. At the same time it may not be feasible to attempt to reduce expenses by wholesale discharges because of the loss of experienced employees difficult to replace in better times. Some people feel that chains have a more impersonal atmosphere throughout their stores than do individually owned stores. They say this is due to the fact that their stores are manned entirely by hired employees.

Merchandise and Service Problems.—Other problems of the chain-store companies have centered around the carrying of merchandise stocks. To achieve the economies of mass buying, they must in almost every case seek to cater to the average customer. Their buyers do not purchase with the needs of individual consumers in mind. They buy on the basis of merchandise records, and they strive to buy only what has been and what they think will be most popular. The result is that the desires and needs of the unusual customer cannot be readily filled. The outsize, the less popular material, the unusual color, the odd price are usually left for the independent store. The chains merchandise for the masses. There are, of course, a few exceptions to this broad statement, but they are exceptions and they are few. This type of merchandise policy, although necessary and desirable from the point of view of effective operation, alienates a number of customers who prefer the unusual.

In many cases the chains have specialized in offering merchandise with a minimum of service. Frequently such common services as the extension of credit and the delivery of merchandise are not available. The absence of these services may divert trade to independent stores. The compensation, for the chain-store customers, is somewhat lower prices.[1] Experience has shown, however, that many people prefer to pay slightly higher prices to stores which offer more than bare merchandise. Even when chains do offer services, they must be offered on a mass basis without the personal differentiation which may be the chief attraction of the independent store.

[1] Various studies show in the grocery field that lack of service does not result in lower prices as much as is commonly supposed. They conclude that there is not much difference in prices between service groceries and cash-and-carry groceries. Other studies show a considerable difference in prices, the spread running as high as 10 per cent.

Rising Costs of Chain Stores.—We have already spoken of the cycle of rising costs which a number of observers have reported as extending throughout the field of retailing. This phenomenon has been present in almost every kind of chain-store operation. The movement to higher rent locations, the employment of better and more skilled labor, the improvement of store appearance, the adoption of new and attractive store interiors and equipment, modern lighting, rising taxes, increased advertising, and more free services have all made themselves felt in chain-store operation. The result has been rising costs. The margin of cost differential between chain stores and competing independent stores has been narrowed year after year as chain store expenses have been rising.

As this margin has narrowed, the early attraction of chain stores as stores in which consumers could economize has been lessened. Some price advantage may still remain. But when comparison is made between chain stores and competing efficient independent stores, this differential usually represents no more than the cost of providing the extra services offered by many independents. The chain stores may still attract patronage because of offering more reliable merchandise under their private-brand labels, or even, as there is good reason to believe, because consumers believe that savings can be made in chain stores.

Chain-store Taxes.—Another and major factor limiting chain-store development is of recent origin. It is the burden of taxation which has been afflicting chain-store organizations with increasing severity in recent years.[1] Antichain-store tax laws have been enacted in a number of states, providing for taxes based upon the number of stores in an organization and rising in direct proportion with the increase in the size of the chain. Taxes of this type have been so severe in some states as to force chains to close many of their outlets. Even where stores have not been closed, the tax burden has contributed to the rise in expenses of operation. It would seem that the purpose of most chain-store taxes has been punitive rather than fiscal.

[1] Beckman and Nolen, *op. cit.*, Chap. XVI.

Buehler, A. S., Chain Store Taxes, *The Journal of Marketing*, January, 1937, p. 177.

Phillips, C. F., An Economic Analysis of the Supreme Court's Decisions on Chain Store Taxation, *The Journal of Business*, January, 1938, p. 51.

The forces underlying this wave of antichain-store taxation are well worth examining because, perhaps more than any others, they hold the key to the future of chains in this country. They have also been responsible to a large extent for certain other laws, notably the fair-trade laws and the Robinson-Patman Act, which have exerted an influence over chain-store development in recent years. Discussion of this legislation is reserved for a later chapter, but the underlying sentiment may be noted here.

Charges against Chain Stores.—As the chain stores grew in popularity and attracted customers through their low prices and their clean attractive stores, the independent merchants found their competitive position weakened. They feared the competition of the chains. Where they could not meet it successfully, they opposed the operation of chains, and, naturally enough, sought ways to impede their continuance in business. It was found that a fairly strong case could be built up against the chain store. The case did not always rest on logical and rational grounds; it was in part emotional; not all its arguments would hold water. But when all the arguments were put together, they formed an attractive and fairly respectable case against the chain store.[1] It was pointed out that chain stores were operated from the leading financial centers of the country. They took money out of the local community and transferred it to New York, Chicago, or some other large city. They drained away local funds. They played no part in local community life. Chain-store managers were shifted frequently, and, unlike the local independent merchant who lived and worked and spent his money in his home town, the chain-store manager was at best a semistranger who did not and could not share actively in the community's business and social life. It was charged that chain stores paid low wages, that they sold poor merchandise, that they encouraged clerks to shortchange and short-weight customers. But above all, the burden of the complaint was that they were destroying the small independent merchant who had always been the mainstay of American business.

[1] Beckman and Nolen, *op. cit.*, pp. 234–239. These pages enumerate 13 charges made against the chain store, together with a short discussion of each.

P. H. Nystrom in "The Fallacies of Anti-chain Store Taxation," pp. 9–11, Institute of Distribution, Inc., 1938, defends the chain stores against some of these charges.

Some of these claims were obviously false, or, if true, no more true of chain stores than of independents.[1] Others were soundly made, particularly those which centered about the participation in local community life. But good or bad, they were successful in convincing many voters and many legislators that the chain store was universally an evil institution and should be hampered and hindered and, in some cases, taxed out of existence. We have not seen the end of that wave of feeling. The chains have been aware of its existence and have done what they could to dispel it.[2] They have opposed partisan taxes and have been successful in some states.[3] They have attempted to take a more active part, through their managers, in local community life. They have publicized their personnel policies. They have tried to gain consumer trust for their merchandise and their merchandise policies. The movement has not abated, although many successful independent merchants have stated that only the inefficient merchants have suffered from chain-store competition and have asserted their own ability to survive against such business competitors. If the movement continues, chain stores may come to hold a much less important place in distribution than they have attained since 1925.

Voluntary Chains.[4]—The struggle of independent stores to hold their trade against chain-store competition has led to the adoption of many of the chain-store management techniques. Independents and wholesalers have cooperated in organizing voluntary chains.[5] These organizations are distinguished by individual independent store ownership, but with centralization of many management functions. A number of independent grocers may combine and form a wholesale house to do all their

[1] Faville, D. E., Comparison of Chain and Independent Grocery Stores in the San Francisco Area, *The Journal of Marketing*, October, 1936, p. 87. This article discusses a survey which was made "to obtain some measure of the relative contributions to their communities by both chain and independent grocery stores."

[2] Beckman and Nolen, *op. cit.*, pp. 238–239.

[3] *Ibid.*, pp. 240–241.

[4] The Federal Trade Commission defines a voluntary chain as "an association of independent retailers acting cooperatively either by themselves or with a wholesaler to obtain advantages in buying, advertising, or in performance of other merchandising functions or activities." In reality these are not chains since the stores are individually owned and bound together only by an agreement which, as a rule, can be terminated on short notice.

[5] Also spoken of as "cooperative chains."

purchasing, while they agree to confine their buying to that single wholesaler. The wholesaler also provides managerial counsel, prepares advertising, and guides independent managers in uniform store-accounting methods. Such an organization may be successful in promoting its private-brand merchandise. The same type of organization has been developed in other merchandise lines. Through the voluntary chain, independents have been able to maintain private ownership of small stores and at the same time to secure the benefits of large-scale buying, eliminate the wholesaler's promotional and sales-force expense and match the managerial and advertising skill provided by the centralized organizations of the chain stores. In spite of this it is doubtful if the voluntary chain gives the consumer as low prices as do the chain stores. However, they are somewhat lower in price than the other independent stores.

Voluntary chains, organized either by a group of independent-store operators or by a wholesaler fearful of losing his independent customers as the result of chain-store competition, have multiplied in recent years. They have strengthened the competitive position of the independent retailer, enabling him better to meet chain-store competition without relinquishing his unique advantages of private ownership and customer confidence built up through personal dealing with an established member of the local business community.

Integration.—One of the more significant aspects of the modern development of large-scale retailing has been the integration of manufacturing and wholesaling with retailing. The process of vertical integration, uniting mines with factories and railroads, is one that is familiar in the industrial field. More recently it has been extended to distribution. Chain stores and even a few large department stores have engaged in manufacturing operations. They buy direct from manufacturers and perform the wholesale functions of transportation, storage, and breakdown into small units. It has been claimed that this process of integration lowers costs of distribution. Elimination of handling charges, cost of extending credit and collecting accounts, and reduction of selling costs[1] and of promotional expenses can easily be seen. Whether or not these savings compensate for the

[1] As an example of the saving which should result here it is estimated that one-fourth of a wholesaler's total operating costs are due to his selling expenses.

expense of setting up and maintaining a wholesale organization must depend upon the volume of operations handled. If the chain is large enough to utilize its wholesale organization to the full, the savings may well make the integration worth while. If the flow of merchandise through its wholesale division is small and irregular, however, the savings resulting from the performance of wholesale functions will probably be outweighed by the expense of maintaining a wholesale division which is seldom fully utilized.

Other Aspects of Large-scale Retailing.—Other developments of modern retailing which are of more than momentary interest include the rapid multiplication of services offered to customers by retail stores; the development of new types of retail stores and stores carrying new combinations of merchandise; the increased use of installment selling; and changes in retail trading areas which have increased or diminished the patronage of stores in a manner wholly beyond the control of store proprietors.

These phenomena are all around us in the stores we patronize. Services, first offered as a few necessary accompaniments of merchandise, in recent years have become weapons of competition. Stores boast of the services they offer and constantly add new ones. Perhaps more than anything else, this has been responsible for the rising cost of retailing. It is much easier to add services than it is to discontinue them. Customers learn to expect them and quickly shift their trade when they are no longer offered.

New types of retail stores and new merchandise combinations have often developed from a better understanding of consumer buying habits. There has been a rearrangement of merchandise lines in department stores, designed to ease the task of shopping. The location of merchandise in variety chain stores is one of the more important tasks of store management. Drugstores have introduced dozens of new merchandise lines which consumers prefer to purchase as convenience merchandise. The old-established store types have in many cases almost vanished in what has been aptly called an era of "scrambled merchandising."

The increased use of installment[1] selling has made possible the sale of expensive merchandise to consumers in the middle and lower income groups. It has resulted in a tremendous expansion

[1] Discussed at length in Chap. XV of this text.

of the consuming market. Like the extension of services, however, it has not been without attendant dangers. In recent years competing stores have liberalized installment terms, the amount of the down payment, and the length of time during which payments may be made, frequently with little regard for either the dangers or the costs. The restriction of installment selling within safe limits has not been the easiest task of retail management.

Changes in retail trading areas have been hastened by the use of the automobile and improved roads. This movement has enlarged the areas in which city stores find customers. It has been responsible for the growth of suburban trading centers around the larger cities. In these new trading centers stores have prospered and new types of stores, such as the department-store suburban branch, have been opened. In the central trading areas trade has slackened. For all these reasons and still others too numerous to mention, retailing has constantly experienced change. The largest retail organizations have not been immune. They have felt it, perhaps, more keenly than the small stores. Growing more inflexible with their increasing size, they have often been less well adapted to meeting change.

PART III

MARKETING ACTIVITIES

Part II contains the story of distribution as it might look if stretched out in a single long line. Now take a cross section of marketing. Marketing is so complex that an examination from only one point of view may present a distorted picture. If the cross-section view is added, you may have a better conception of the marketing process.

Part III presents the cross section. Here is the story of the specialized activities or functions which are being performed everywhere in marketing.

CHAPTER X

SELLING

"An effective selling campaign does not increase the cost of the products sold. Rather, it widens the market, increases sales, and eventually brings about a reduction in the selling price."

What Selling Does.—This has been called an age of salesmanship. Increased emphasis has been placed in recent years on the arts and devices of selling. Courses for training salesmen are offered everywhere. Advertising as a selling tool has been subjected to careful examination. New techniques have been developed for analyzing markets; new devices for determining the effectiveness of advertising. Publications circulate millions of copies carrying selling messages. Experts check and recheck the sales which result from advertising. New methods of packaging are developed. Stores blossom with new ways of displaying merchandise. The symbol of the salesman has become almost synonymous with American business. How important really is selling? Do all these elaborate devices really pay? Do they contribute to increased efficiency in distribution?

The practice of marketing as it is carried on by successful business concerns leaves little doubt that the phrase "demand creation" is a misnomer. "The satisfaction of consumer wants" would be a more accurate description of the activities of the selling programs of American business. The most successful sales campaigns have devoted the greatest part of their attention to supplying existing wants rather than to creating new ones. It is true that demand creation in the sense of arousing new wants and bringing them to the consciousness of consumers does exist as a marketing force, but it is distinctly subordinate to that other phase of selling which devotes itself to bringing to the attention of consumers merchandise which may satisfy those wants they already have.[1] It is this part of the selling program which really

[1] Sale to the consumer involves various bases of sale: sale by inspection, or by sample, or by description. Sale by inspection calls for an inspection of

approaches the basic problem of salesmanship. A consumer must want a particular kind of product, and he must then be induced to purchase that product from a particular manufacturer. To accomplish this result all the arts and devices of salesmanship described in the preceding paragraph have been elaborately built up by the machinery of modern marketing.[1]

Reason for Emphasis on Selling.—The modern emphasis on selling is an outgrowth of the need for disposing of the expanded production of giant manufacturing plants. More and more intensive distribution, the selling of more merchandise to existing consumers, and the discovery of new consumers are primary requirements for the continuous operation of our manufacturing plants. Without such successful salesmanship the owners of productive equipment would soon find themselves turning out merchandise which no one wanted. Soon after the inventories of unsold goods had begun to accumulate in this way, it would be necessary to close down the factories and produce no more. The modern emphasis on selling must always be viewed, therefore, as a necessary concomitant of large-scale industry. It does not necessarily represent either a waste of money or a waste of effort, although, as will be pointed out below, many of its manifestations may indeed include examples of waste.

Sales Methods.—In selling the output of an industrial plant several methods may be employed. A sale may be made as a result of the satisfaction derived by the consumer in using the article.[2] A sale may be made as a result of the independent solicitation of a salesman. A sale may be made as a result of

the actual merchandise. For instance: The customer in a retail store picks out a dozen peaches from those on display. A breakfast food company distributes samples from door to door. A catalogue of a mail-order house, such as Sears, Roebuck and Co., would be an example of sale by description.

[1] Francis, Clarence, A Challenge to Marketing Men, *The Journal of Marketing*, July, 1938, p. 27. The president of the General Foods Corporation in discussing the sales activities of modern business states the following objective: "Getting more goods, and better goods, into more and more homes! . . . Helping more people to enjoy the products of American industry. . . . Making the farmer's income go further. . . . Replacing the obsolescent with modern improvements. . . . Enabling the millions of workers on the payrolls to purchase more of the things they manufacture so well."

[2] This would be a "repeat" sale rather than an initial sale of a product unless the satisfaction came through the use of a sample.

advertising in many of its multifarious forms. Or, of course, a sale may be made as a result of a combination of these methods. The most successful selling programs have been evolved through a studied program unifying these various methods of selling merchandise. In some cases one aspect of salesmanship may be emphasized, in some cases others.

Each company's selling program must be developed after an examination of the merchandising problems peculiar to that company. As elsewhere in marketing, the common experience is lack of uniformity. Companies which have blindly followed the lead of other concerns in the same industry have rarely achieved the success of those they have imitated. An efficient merchandising program depends as closely upon the selling problems of the company trying to use it as efficient factory operation depends upon the operating problems of the company involved.

In the intensified competition of modern marketing, the sales divisions of companies assume the position of bottlenecks. Unless they can keep merchandise flowing swiftly out of the factories and into the hands of consumers, production must slow down and eventually fail. Consumers must continuously be shown the advantages of new products. When their desires for new products have been aroused or when they are aware of their ability to satisfy existing needs, they must be shown the advantages to be secured from purchasing particular brands of those products which they want to buy. The press of competition has been responsible for the tremendous growth in printed advertising. This has been made possible and in turn has been carried by the vast number of periodicals of all kinds which circulate in the American market.

Wastes in Selling.—There are, of course, confessed wastes to be found in this selling procedure, but even the severe critics of marketing methods admit that the result has been to pass on to the consumers of this country a larger flow of goods and services and thus to raise the standard of living.[1] The question of costs,

[1] Benson, John, Advertising Looks Ahead, *The Journal of Marketing*, January, 1937, p. 241. "As to economic waste, there is a simple and self-evident answer: If advertising did not lessen the cost of distributing goods by economizing sales effort it would not be employed. If any less expensive method could be found, it would be promptly adapted. Competition would see to that."

which has been raised from time to time, in this volume enters here as a vital factor. Much of the debate about advertising centers around the question of whether advertising increases the cost of merchandise, or, as a result of increased sales, costs of production are lowered and the total cost to consumers becomes less.[1] Obviously, in some cases prices are forced up, and in other cases prices may be lowered. A number of writers on this subject appear independently to have reached roughly similar conclusions. They seem to agree that viewed from its social aspects alone advertising is desirable when it succeeds in selling more merchandise without at the same time bringing about an increase in the retail prices of the goods sold. When prices are driven up in the effort to pay the advertising bill, they agree that the social value of advertising becomes dubious.

There are wastes in competitive selling. Naturally it is expensive to convince potential purchasers that one product is vastly superior to other products of the same type. It is expensive to maintain this volume of advertising month after month and year after year. It is expensive to attempt to implant in consumers the habit of specifying a brand when they purchase a product. It is expensive to attempt to build in the minds of consumers a belief that certain brands have unique qualities.

It has been said that there are too many firms operating in some lines of business; that there are too many brands of certain types of products. Of course, this amounts to saying that there is too much competition. It has been said that superfluous competition increases the costs of selling, and that it does this because money is wasted attempting to direct the purchases of consumers whose minds have already been made up and who are merely confused by advertising claims.

No one can assume sufficient wisdom to venture a complete reply to these charges. There are occasions when sales-promotion efforts are wasteful. There are many occasions when selling

[1] Francis, *op. cit.*, p. 31. "When General Foods first took over the Jell-O Company, Jell-O was selling to the consumer for an average of 12¢ per package. Today the prevailing price is around 5½¢ to 6¢ per package. The decrease in price has been made possible only by successive increases in output, and the successive increases in output have been made possible, partly at least, through advertising. The total advertising cost at the present time is under one-half of a cent per package—what is wrong with advertising when it works that way?"

programs needlessly increase the cost of distribution. But the force of modern sales promotion taken in its entirety has been a vital contributor to the successful distribution of the products of our factories. Hundreds of specific examples can be cited to show situations where advertising, by greatly expanding the market for a product, has lowered the cost of production and the price to consumers. Perhaps the only safe conclusion to reach is that no generalization in this field is safe, but that the promotional program for each company must be judged in relation to the facts of that particular situation.

Other Factors Causing Waste.—Another influence affecting modern promotional programs has been the increasing importance of style. Formerly many types of merchandise were used by consumers until physically they were no longer usable. At the present time we recognize not only physical obsolescence but style obsolescence. Many articles used in daily life are replaced long before they have been physically worn out or used up. They are replaced simply because they are out of style. They are out of style because new styles have arisen and have been popularly accepted. In large part, of course, the increase in the importance of style has been fostered by producers through their promotional programs in the effort to maintain factory operations. In part, the change in the public's attitude toward merchandise has been the result of the wider spread of education and of social contacts through such media as the motion pictures, newspapers, magazines, and the radio. The general effect has been to speed up production and to increase the tasks of sales promotion. Again the question of social wastes has been raised without satisfactory answer.

Another cause of high selling costs has been the inability of consumers to judge the quality of the merchandise which they purchase. Numerous commentators have pointed out that consumers generally are unskilled as buyers.[1] In large part, of course, this condition exists because they lack the equipment for making satisfactory tests. It is true, however, that, because of the inability of consumers to judge the quality of what they purchase, a variety of products are offered on the market which may differ from one another very slightly. Each one is supported by an elaborate selling program and the total effect may

[1] See discussion in Chap. II of this text.

indeed be, as a number of commentators have indicated, to increase marketing costs without compensating advantages. One measure of the potential waste involved in this haphazard method of purchasing may be gained from the estimate that the Federal government spends 2 million dollars a year in testing merchandise and preparing specifications. As a result of this outlay it is reported to save 100 million dollars a year on purchases of 300 million dollars.

Another waste in selling is due to artificial barriers which have been raised to trade between states.[1] "It develops that public health and sanitation measures may be so designed as to restrict trade across state lines. The same may be said of certain tax laws, of motortruck regulation, of quarantines, of grading, labeling, and packaging laws, and of State financed advertising of farm products." These barriers either prohibit trade between the states or make it more difficult thereby increasing the selling costs.

With all its wastes and with all its accomplishments the function of selling may be summarized as the process of distributing the tremendous outflow of merchandise from our factories and from the farms, the forests, and the mines. It includes every variety of sales-promotion device necessary for accomplishing a sale. Many parts of selling are indeed expensive, but any judgment of their value must consider the relation of the selling program to the production program. It must consider the effect upon production costs which would be brought about by a reduction in selling costs.

Building a Selling Program.[2]—Concerns engaged in modern marketing have developed a well-defined procedure for building a selling program.[3] They begin by analyzing the nature of consumer demand. They attempt to find out everything about buying habits with respect to a new product: how people buy it, in what types of stores, how often they purchase, how much they want to pay, whether they specify the brand at the time of

[1] "Barriers to Internal Trade in Farm Products," a Special Report, United States Department of Agriculture, 1939.

[2] Walter, L. Rohe, "Effective Marketing," McGraw-Hill Book Company, Inc., 1938.

[3] Strong, E. K., "Psychological Aspects of Business," McGraw-Hill Book Company, Inc., 1938. Chapter XI discusses the psychological aspects of such consumer research.

purchase. These questions must be answered before any thought can be devoted to the composition of the selling program. It is necessary to determine by a fairly shrewd estimate the number of potential buyers and their location. Only when the nature of consumer buying habits has been carefully studied are the executives ready to turn their attention to the marketing program.

The next step is to examine the product to ascertain how well it fits into the established pattern of consumer demand.[1] If, in its existing form, it does not agree perfectly with the established consumer demand, the next investigation attempts to find out what can be done to change the product or to adapt it more perfectly to established demand. These changes may include the creation of a new product or supervising variations in the old product to make it conform to consumer demand. This entire range of activities relating to product development is frequently included under the title of "merchandising." Merchandising is playing an increasingly important part in modern marketing. Skillful marketing executives take no one's word for the acceptability of a new product. They ask consumers directly.

Neither market analysis nor merchandising is confined to the period before the introduction of a new product.[2] Consumer demand is anything but static and successful selling necessitates constant study of the market and constant adaptation of the product to changes in consumer demand. Many of the leading concerns engaged in selling in this country conduct annual market surveys designed to bring out every possible fact about current consumer buying habits. Their merchandising activities are carried on continuously, based upon the results of the market survey.

Principal Methods of Selling.—Although there are many ways to make a sale, there are really just two principal methods of selling: personal selling and advertising. The first involves a contact between consumer and salesman. The second involves

[1] Doubman, J. R., "Salesmanagement Today," pp. 47–54, Dodd, Mead & Company, Inc., 1933.

Cowan, D. R. G., Product Testing and Its Value to Business, *The Journal of Business*, October, 1938, p. 349.

[2] Arnold, Pauline, How Research Builds Sales, *The Journal of Marketing*, October, 1937, p. 134. This article discusses nine cases where market research has been used either to initiate a sales program or to modify a sales program.

a contact between the consumer and the printed or spoken word serving as a salesman. Few concerns depend solely upon either one of these two principal methods of selling. There are, of course, some businesses which use only salesmen and do not advertise. There are others which use only advertising and have no salesmen.[1] But the great majority of businesses attempt to build a sales-promotion program which includes every type of selling, using both salesmen and all varieties of advertising. Experience has shown that such a well-coordinated program is usually the one which produces the best results per dollar spent for sales promotion.

This type of sales promotional program seeks to put each sales activity to its best use. Personal selling can search out prospective buyers, can use arguments designed to meet the objections of each individual buyer, can make selling flexible, can give immediate answers to buyers' questions, can make effective demonstrations possible, and in every way can bring the prospective customer close to the merchandise and strengthen its appeal for the customer. A salesman cannot be with his customers at all times, however. Advertising in the various media available provides an effective background for personal selling. It conveys selling messages to customers between the visits of salesmen, stimulates latent desires to purchase, and frequently may be used to select the best prospects who can later be visited by salesmen making personal calls. Personal selling is expensive. Advertising in mass media may project the selling message to a multitude of prospective customers, although, of course, the individual impression received will be much weaker than the impression received from a salesman.

The Sales Force.—The selection, administration, compensation, and promotion of salesmen is one of the most difficult tasks in all marketing. It is a task which cannot safely be overlooked by executives. A good salesman is a rare individual. When he leaves a concern, it may take some time to find a suitable successor. It will certainly be expensive to train him in company methods, and a considerable period may elapse before his work becomes as effective as that of his predecessor.[2] Personnel work

[1] Most mail-order houses come in this group.

[2] D. Gordon Hunter, vice-president of the Phoenix Mutual Life Insurance Company says, "It costs less to develop a successful salesman than it costs to eliminate a failure—after he is hired!"

has been developed to improve the skill of selecting individuals for selling positions. Today most companies regard as one of their chief assets a skillful, experienced, and well-trained sales force. The selection and administration of a sales force has become a specialized executive task, because of the high cost of doing the job right and the still higher cost of doing it wrong.

In selecting salesmen, a company may choose from one or more of various sources.[1] It may advertise in publications read by salesmen, it may hire men away from other firms, it may promote within its own organization, or it may secure untrained applicants from schools and universities. No one policy is uniformly followed nor has experience been sufficient to prove that a salesman secured from one source is regularly more valuable or better than one secured from another source. Psychological tests are frequently used to measure the prospective salesman's ability and aptitude. His previous experience is consulted as a guide to his future success, but a large part of the task of selecting a salesman still remains within the realm of individual human judgment based upon one or more personal interviews with a hiring official.

Training Salesmen.—The training program which begins for the new salesman is built around three things: the attempt to instill in the salesman a knowledge of the product he is selling; the attempt to teach him the technique of selling; the attempt to develop in him a pleasing personality so that he sells himself as well as his product.

The importance of training was overlooked until recent years. The increased complexity of marketing, the more mature competition which has developed, the increase in the size of companies, and the use of cost accounting to reveal the high expense of a rapid turnover in the sales force have all combined to emphasize the need for training. A well-planned training program may assist a company to secure increased sales from its existing sales force. This in turn will bring about a decrease in selling costs. The program may also aid in developing customer good will. Merchandise returns may be reduced because goods have been sold carefully and customers have been satisfied with them. The turnover of the sales force is reduced by such a program,

[1] Aspley, J. C., "The Sales Manager's Handbook," Secs. 13, 14, The Dartnell Corporation, 1937.

because men not adapted to selling or to the company's needs are weeded out in the selection process or during the training program. Those who survive these two tests are usually well adapted to the work they undertake. They tend to be satisfied with what the company has to offer them, and they stay with the company for a longer time. In this way the expense of maintaining an elaborate training program is more than compensated for by the benefits derived from reduced labor turnover and from better selling. In addition, men of high caliber may be attracted to this type of work with a consequent improvement in customer relations and in the morale of the company's sales force.

Sales-training Programs.—It is not easy to develop a good training program. Some companies have plunged into this type of work without adequate preparation and have become thoroughly dissatisfied with the results. Other companies have hesitated to introduce training programs because their executives thought themselves inadequate to direct such activities. The experience of our more successful concerns appears to prove, however, that the cost of developing a good training program is much less than the cost of not doing so.

Among the subjects usually covered in a training course may be the following: the product; how it is made; what it may be used for; who uses it; how the concern which makes the product is organized; its history; its business principles; its technique of record keeping; its selling and advertising policy; its credit policy; the policy it maintains for dealing with customers; principles of general salesmanship; special selling techniques which have been developed for selling this particular product; and, frequently, general personality education designed to improve the prospective salesman's manners, dress, method of speaking, approach to customers, and confidence, and to help to form a plan of work.

Sales Management.—After salesmen have completed the training course, however formal or informal it may be, varying with the size of the firm, the task of managing them in their work must be faced. Not only must the new salesman be trained before he begins to sell; he must frequently be trained in the field, his instruction being based upon his own mistakes. He will certainly learn more from his own selling experiences than in the preselling training program, but he will learn only if he has

someone to guide him, to correct his mistakes, and to assist him in improving his selling practices. Even experienced salesmen long in the employ of a company must be supervised continuously. Administration of this nature will improve their efficiency and will maintain that careful control over the cost of selling which can be exercised only by an administrative official.

This administrative supervision may be carried on both by mail and by personal contact. If the sales force is large, the company will frequently employ district supervisors. Experience has shown that administration is difficult when the administrator is at a distance from, and unacquainted with, local conditions. Here, as elsewhere in business, personal contact and supervision is more expensive than indirect contact through the mails. Again, however, it has been frequently found that the more expensive type of administration is, in the end, the less expensive. It secures better selling, lower costs per salesman, and lower costs per unit sold.

The type of organization which may be found in any company's sales force depends upon the individual selling problems of that company.[1] It depends upon the number of customers who are to be reached, upon their location, upon the product or products which are sold, upon the complexity of the selling task, upon the frequency with which salesmen must make calls, upon the supervision which is required, and upon the extent to which it is desirable to have salesmen specialize. In general, however, sales organizations tend to specialize in one or more of the following ways: by territory, by product, or by customer.

In one firm, for instance, one salesman may sell the company's entire line to all customers in a single territory. In another firm one salesman may sell only a certain product or a group of products in the entire line. In other cases a salesman may sell only to certain customers, leaving other classes of customers for other salesmen. One large company may, within the range of its own sales force, offer examples of each of these types of specialization. In every case, however, successful selling is based upon the adaptation of sales organization to the needs of the company concerned. The most successful companies have been those which have not modeled their sales organizations upon any established rules of procedure, but have

[1] *Ibid.*, Sec. 10.

sought in every case to study first the selling problems and then have attempted to solve them as effectively as possible.

Compensation of Salesmen.—Much discussion has arisen about the various methods of providing incentives for salesmen.[1] Contact is maintained between the salesmen and the office by means of letters, by conferences, and by conventions. Contests are frequently employed to introduce competition in selling. The present trend in the field of incentives appears to be against the inspirational letter or the "circus" type of convention. Most executives now recognize that compensation in its various forms is the most effective means of promoting hard work. Conventions are usually employed to secure personal contacts between executives and salesmen and, as many writers have pointed out, to provide a place where selling ideas can be exchanged. It is true, of course, that there is an element of company loyalty, which, if present, supersedes compensation to some extent, but basically all men are interested in how much they can earn. The profit motive seems to prevail in the compensation of salesmen as much as anywhere else in the economic world.

The compensation of salesmen is a complex problem in itself. Any system of compensation should possess certain attributes. It should attract the type of men desired by the company using it. It should be easy to understand and easy to administer. It should provide payments which direct the salesman's efforts toward those things which the company wants done. It should satisfy the salesman by being fair, regular, and adjusted to his efforts. Within the limits of these broad principles there may, of course, be a great many types of compensation. There may be a straight salary payment, straight commission, profit sharing, bonus, or any combination of these systems. There is no single compensation plan adapted to every company in all conditions. In the business world every variety of compensation system may be found, and successful examples may be offered to support the use of all types of compensation methods. A company's compensation plan should be adapted to its own selling problems.

Certain statements can be made, however, about the major types of compensation methods. The straight salary payment plan is easy to understand, provides a sure income for the sales-

[1] *Ibid.*, Sec. 15.

man, and gives the sales manager greater control over his men because they do not feel that they are working for themselves as they may under a commission plan of payment. On the other hand, it does not always provide compensation adjusted to sales results. As a result, it may discourage extra selling efforts and may involve the company in heavy selling expenses during times of depression when sales necessarily are low. It is best adapted to selling merchandise which necessitates prolonged work by the salesman before the sale is consummated. It is also frequently used when the sale of the merchandise requires engineering advice and service. Companies selling heavy industrial equipment subject to severe sales fluctuation as a result of the business cycle often select the straight salary payment plan as the method of compensation best adapted to their selling problems.

The straight commission plan of payment furnishes the most powerful direct incentive. It is easy to administer and to finance and it reassures the company against the risk of high selling expenses during depressions. The company's sales-force expenses are perfectly adjusted to actual sales. On the other hand, it may put pressure on salesmen to secure volume of sales above all other considerations. Frequently there are cases where the salesman has to make contacts which will not produce immediate sales, or he has to carry on consultation or advisory work. Salesmen on a commission basis begrudge the waste of their time on such unproductive activities. They feel much more independent when they are paid on a straight commission basis. They are harder to control. They tend to call upon customers who make large purchases and to neglect poor customers or potential customers. They may not follow the route established for them by the company, which may contribute to higher expenses. They may become too willing to grant price concessions in order to secure sales. Such practices can better be controlled under a straight salary method of compensation. The straight salary system and the commission system are often combined in such a way as to secure many of the benefits of both. and to avoid many of the disadvantages.

Advertising as a Form of Sales Promotion.—Every aspect of selling and advertising must be included under the title "sales-promotion activities." In the field of advertising this covers a wide range of media. Advertising may be carried in newspapers,

magazines, trade papers, and farm papers; over the radio; on billboards and signs of all kinds; in catalogues and pamphlets; in window and interior store displays; and by numerous other methods of effecting contact with consumers. In the well-organized advertising program careful coordination is effected between the various media. A number of companies have found that a rounded program which uses a great many means of reaching consumers with selling messages is many times as effective as a program which is confined to one or two of the leading media. Several very successful promotional campaigns, however, have been founded on concentrated advertising in two or three media.

There are other divisions of the advertising program. Manufacturers advertise not only to consumers but also to retailers and wholesalers. Not only do they attempt to induce consumers to ask for their products in retail stores, they also try to induce wholesalers and retailers to stock their products. This increases the exposure of their products before consumers and in many cases brings about additional selling efforts by wholesalers and retailers which may contribute to increased sales. Still another division of the advertising program may be made between that part which attempts to lead consumers to take immediate action and that part which is designed to serve as background or to build up favorable associations in the minds of consumers leading to eventual purchase. This distinction is sometimes described as the division of advertising into direct-action advertising and indirect-action advertising.

Modern marketing is making increased use of advertising.[1] The amount of advertising carried in various media at the present

[1] L. D. H. Weld gives an estimate of the amount spent annually in advertising (*Printers' Ink*, June 16, 1938, p. 19). Dr. Weld emphasizes the fact that these figures are estimates. He places the total figure at $1,768,000,000 for 1937. This total is divided as follows:

Newspapers	$ 570,000,000
Outdoor	50,000,000
Magazines	165,000,000
Farm papers	18,000,000
Radios	165,000,000
Direct mail	300,000,000
Premiums	350,000,000
Business papers	50,000,000
Car cards, theater programs, etc.	100,000,000
Total	$1,768,000,000

time represents a tremendous growth when compared with the practice of 25 years ago and even a greater growth when compared with earlier practice. In part, this is the outcome of the necessity for seeking larger markets; in part, it is the result of the increased severity of competition and the multiplicity of brands of various products which are now presented to consumers. More media are now available for reaching consumers. These have been supported by increased advertising and in turn have made possible the expenditure of large sums for the effective distribution of selling messages.[1]

What Advertising Does.—Advertising facilitates mass selling, it is true, but it does much more. It may save time and effort for consumers by bringing the information necessary for skillful buying. It may help to introduce new products or to maintain a demand for old products. It may describe new ways to use products or reasons for making greater use of products in known ways. It may replace part of a personal selling program and so assist in effecting economies in personal selling costs. It may be used to reduce seasonal fluctuations in business. It supplies dealers, salesmen, and consumers with information about the product, designed to ease the selling process.

Not all advertising is successful. Much money spent for advertising is wasted. It is not true that advertising will sell anything. Successful concerns operate on the principle that advertising can be profitable only when it has a worth-while message to relate and when that message is skillfully presented.[2] To be advertised and sold successfully, a product must be adapted to consumer desires and must possess some unique point or advantage which will attract consumer patronage. The mere expenditure of large sums of money for advertising, without careful planning, without careful administration, without careful measurement of the sales results, can lead to tremendous wastes. Not every product needs advertising or benefits from its use. Few products can be sold by advertising alone. Every product which uses advertising benefits from a careful coordination of advertising with every other element of the organized marketing program.

[1] Aspley, *op. cit.*, p. 702, gives the average percentage of total appropriations spent in each medium by 285 advertisers in various industries.

[2] Benson, John, Trends in Consumer Advertising, *The Journal of Marketing*, July, 1938, p. 20.

The Case Against Advertising.—The charge that advertising leads to wastes in the marketing process[1] rests upon the following arguments: It is pointed out that advertising emphasizes minor differences in various brands of the same product and often serves merely to divert purchasing from one brand to another without affecting the total demand for the product as a whole. It is stated that advertising increases the number of grades and styles of merchandise offered for sale and so increases the cost of distribution. It is also stated that advertising tries to quicken the style cycle so that merchandise will be discarded by consumers before its physical utility has been exhausted.

There is much truth in these charges.[2] Not all advertising is economically justified.[3] As we have pointed out before, however, where it is wisely used to enlarge a market for a product and thereby to bring about a decrease in production costs, it is a valuable and efficient marketing tool. Its misuse has been a characteristic of unplanned marketing. With the growing maturity of the advertising business, wastes are slowly being eliminated. Manufacturers and advertising agents are devoting greater attention to the careful measurement of advertising results.

Governmental, trade, and consumer bodies have objected to specific evils in advertising, to misleading claims, to the use of paid testimonials, to the widespread publication of distorted emotional statements, and to the bad taste which frequently appears in advertising copy. Within the advertising business itself the recognition of these evils has served as the basis for self-improvement. There is no point in denying that they are evils. It is true that the advertising business needs a measure

[1] Massey, John R., College View of Advertising Not Moscow Tainted Say Comrade Professors, *Printers' Ink*, Oct. 20, 1938, p. 11. This article presents varying attitudes toward advertising of faculty members in the economics departments of liberal arts colleges and of advertising professors in schools of business.

[2] At the time this book is being written the Harvard Graduate School of Business Administration, under a grant by the Advertising Research Foundation, is making an exhaustive study of the social and economic value of advertising. This study, under the direction of Neil H. Borden, should make a real contribution to this debatable question.

[3] Nixon, H. K., "Principles of Advertising," pp. 58–59, McGraw-Hill Book Company, Inc., 1937. These pages give a Summary of the Economic Benefits of Advertising. Pages 60 and 61 discuss the Social Functions of Advertising.

of policing which has thus far not been forthcoming. But to emphasize these aspects of advertising and to overlook the contribution which carefully directed advertising can make to the greater efficiency of marketing is to be both shortsighted and unwise. The abuses of advertising can be corrected without sacrificing the benefits which are secured from its use under careful management.

Standards in Selling.—An important feature of successful advertising is the identification of the product.[1] The most extensive advertising campaign must fail if those to whom the advertising is directed are unable to identify the product when they buy it. As a result, concerns engaged in marketing usually take great care to identify their products by trade-marks in such a way that consumers know what they buy when they purchase. This minimizes the danger of receiving an inferior or substitute product in place of the brand requested. It strengthens the possibility of consumers specifying a brand when they purchase. Through law and practice, a great many restrictions have been built up around the identification process, generally with the purpose of protecting the users of trade-marks and other identification features. To be most effective, trade-marks must be simple, easy to pronounce, distinctive, easy to learn, suggestive of the good quality of the merchandise, and legally protectible. It must be remembered that consumers at all times associate the product with the manufacturer. A brand guarantees to consumers uniformity; at the same time the reputation of the manufacturer may be seriously damaged if any unit sold under his brand name proves defective or unsatisfactory.

From the sellers' point of view, therefore, there is great need for developing and maintaining satisfactory standards for merchandise. This eases the selling program, provides for continuity of good will, and makes possible sale from sample. Standards provide guarantees of continuous uniformity of quality. From the buyers' point of view standards afford greater protection; they assist in the development of sound consumer purchasing; they protect the consumer against dishonesty by wholesale and retail merchants; they offer him a guide for the elimination of unsatisfactory merchandise offered under the brand of the manufacturer.

[1] Aspley, *op. cit.*, Sec. 3.

The Marketing of Services.—The marketing of services has an importance in the general scheme of distribution which has frequently been overlooked.[1] A large part of all those engaged in the marketing process are engaged in the distribution of services. Some of these services may be sold in connection with merchandise, as in the offering of credit and free delivery. There are very few products which consumers purchase which are sold without accompanying services. In almost every retail price is included the cost of supplying those services. So accustomed have consumers become, however, to thinking in terms of buying merchandise that they often forget that they are also purchasing services and paying for them. A great many services, of course, are sold separately. A large number of personal services and professional services are sold only as services without accompanying merchandise. In this class may be included the services of doctors and barbers.

The general characteristics of services, whether personal, mechanical, electrical, financial, or any other type, possess unique features which distinguish them from merchandise. These unique features further complicate the marketing of services. Personal services are among the most perishable commodities. If not utilized, they cannot be stored. They are not easily standardized or graded, nor can consumers readily distinguish between them by quality-price comparisons. In most cases they are sold directly by those who supply the services and consumers do not deal with the manufacturers through a variety of intermediaries. Much reliance is placed on the professional or semiprofessional integrity of those who supply the services.

Despite these characteristics, however, it should be emphasized that many of these services clearly are sold as merchandise. They are advertised; they may require or they may themselves supply financing; they may require the incurring of risk or they may themselves provide for safeguards against potential risk; they are vital to the distribution of merchandise, and, even without merchandise, their continual supply is vital to our daily

[1] Glover, J. G., and W. B. Cornell, "The Development of American Industries," Prentice-Hall, Inc., 1932. A number of chapters discuss various services and should prove interesting reading to the student of marketing.

lives. They must be thought of as an important part of the entire picture of distribution, a part which in recent years has attracted a growing number of workers.

Summary.—A summary of this chapter must draw attention to one important point. Selling is most effective when it coordinates every aspect of the selling program. It is least effective when, hastily planned, it relies upon a few selling activities for the distribution of merchandise and services. A successful selling program is not the result of chance, nor, once established, can it be maintained without change. It must be as flexible and as adaptable as consumer demand itself. It must be continually fitted to the shape of consumer demand. This means that the executives who administer a selling program must be resourceful and must possess a fund of knowledge about consumers and their buying habits which can be secured only through unremitting study of the market for their products. A recognition of these facts has been responsible for the less wasteful and more successful selling programs developed by companies in recent years. There is still, however, tremendous room for improvement. Many of the wastes of selling which have been most bitterly attacked by critics have been due to a lack of understanding on the part of marketing executives of the dependence of successful selling upon these very points.

CHAPTER XI

BUYING

"We have been buying since the dawn of history and we still know next to nothing about it. There is more waste as a result of inexpert buying than in any other part of distribution."

The Problem of Buying.—The usual picture of buying is that of the consumer in the retail store, with money in her purse, making up her mind what to purchase. This, it is true, is the end of the long line of distribution. But it is only part of the complicated process of buying which is vital to successful marketing. The little knowledge of the consumer is inferior to the greater knowledge of the buyers of merchandise for retail stores, wholesalers, and manufacturers. Yet with all the knowledge of the business purchaser, skilled and experienced as he is, a great part of the buying task is based upon individual judgment. Errors are frequent.[1]

A survey of buying practice throughout distribution may help to emphasize its importance and the many difficulties which are encountered. It may also serve to illuminate the area where mechanical and statistical assistance may be employed.

Industrial Buying Practice.[2]—We have already pointed out that direct contact between producer or manufacturer and purchaser is much more frequently found in the field of industrial merchandise than in the field of consumers goods.[3]

[1] H. H. Shively, in The Nature of Unfair Methods of Competition in the Retail Field, *Ohio State University Studies, Bureau of Business Research Monograph* 10, February, 1928, p. 29, reports the assembly by the New York Better Business Bureau of 90 unidentified suits and overcoats from various stores. Appraisals by manufacturers and buyers yielded estimates of retail prices ranging from 40 per cent below the correct retail prices to 40 per cent above.

[2] Frederick, J. H., "Industrial Marketing," Chap. IV, Prentice-Hall, Inc., 1934.

Lewis, H. T., "Industrial Purchasing," Prentice-Hall, Inc., 1933.

[3] Chapter IV of this text.

As purchasers of industrial goods, manufacturers frequently buy raw materials direct from the sources of supply. The same practice is often found in the purchase of manufacturing parts, of machinery and of capital equipment used in the manufacturing process. The place of the middleman in the sale of industrial goods is relatively minor in importance. Middlemen are active in the distribution of merchandise of small unit value or merchandise which finds a market in a great many different kinds of businesses. They are unimportant in the sale of specialized equipment or specialized raw materials.

The manufacturer who serves the consumer of industrial goods often purchases a great many kinds of raw materials, machines, and parts. He has many decisions to make prior to completing the manufacturing process. He must, for example, decide whether to purchase parts from outside manufacturers or to produce them himself. He must decide whether to purchase raw materials from outside producers or to attempt to control his own supply of raw materials. He must decide whether to maintain a large inventory of raw materials and supplies or to buy only for immediate needs. He must decide whether to speculate in long commitments, endeavoring to profit from advantageous forecasting of price movements or to refuse all speculation which possibly can be shifted to other shoulders.

As elsewhere in distribution, the answer to these problems must depend upon the individual situation of the individual manufacturer. He may be guided, however, by such general principles as the size of his operations, the possibilities of securing protection by one means or another against price movements, the danger of a failure of supply, the difficulty of manufacturing parts, and the financial commitments necessary to control the production of both parts and raw materials. Small manufacturers, therefore, usually find it necessary to purchase raw materials and parts from outside producers. Larger manufacturers may decide to own part of, or all, the sources of supply of their raw materials; part of, or all, the transportation facilities necessary; part of, or all, the factories producing necessary supplies and parts. There is no uniform policy to be found covering buying practices. The tendency toward integration under single ownership of raw-material supply sources, transpor-

tation, and manufacturing is most apparent where industry is largest and where the risks of price fluctuations in raw materials or of the stoppage of the supply of raw materials are so great as to outweigh the risks of added financial commitments. The steel industry is an outstanding example of this trend in ownership.

The industrial buyer is a skilled buyer. He knows exactly what he wants. He buys for rational reasons. He is in a position to dictate exact specifications. He is acquainted with all the possible sources of supply. He knows world prices. He has information relating to possible future movements of the prices of those things which he must purchase. He is acquainted with all potential suppliers. Armed with this information, he is usually able to buy with great skill. Few of the mistakes which consumers commonly make are found in the purchasing of manufacturers.

The recognition of these aspects of industrial buying involves a recognition of the significance of the purchasing function as a vital factor in production. A number of writers have pointed out that businessmen have not always granted to the purchasing department the authority and responsibility it should possess.[1] They have subordinated it to the interests of engineers and sales managers, without, perhaps, realizing the close relation which must exist in the successful plant between purchasing, manufacture, and selling. The closeness of this relation can best be illustrated by directing attention to the fact that no decision regarding the production of new items can be reached without considering the availability of raw materials, that no decision regarding price policy can be reached without considering the cost of raw materials and parts, that no decision regarding selling policies can be reached without considering existing contracts for parts and raw materials, and that no decision regarding financial policy can be reached without considering the purchasing budget.

It is a common belief that the industrial purchaser is concerned at all times about securing the necessary raw materials, parts, and supplies at the lowest possible prices. The truth is that in every purchase quality and service must be considered with price. There are many business situations, indeed, in which price is of minor significance. One reservation should

[1] Frederick, *op. cit.*, pp. 49–52.

be added to this conception: consideration of quality need not always mean the purchase of the best quality available. Quality must be related at all times to the needs of the manufacturing plant. Buying by quality means, therefore, buying that quality which is required by the manufacturing operations to be carried on, no better and no worse, and inspecting the receipts to guarantee that the quality received follows specifications.

At the quality level specified, price becomes important. Even at this point, however, price may be subordinated to questions of service and long-time relations with supply sources. It must be measured, as well, against the problem of the size of the order and against the risks of speculative buying.

In recent years the practice of reciprocal buying has become common in industrial purchasing. This represents a concentration of buying and selling interests. The purchasing departments of manufacturing concerns often place their orders with the best customers of the firms they represent. Thus a railroad may purchase steel rails from the steel mill which ships the bulk of its merchandise over the railroad's tracks. Where this practice results merely in the selection of one among a number of competing sources all offering similar merchandise at the same price, it represents normal business procedure. At times, however, pressure is brought on the sales department of a manufacturing concern to influence the concentration of purchasing as a guarantee for future sales. Where this results in purchasing merchandise of poorer quality or at higher prices than could be obtained from other resources it represents inefficiency in buying. So far as the industrial purchasing agent is concerned, when reciprocal buying involves placing orders with less desirable resources, securing poorer quality, or paying higher prices, there is no question that it constitutes poor business practice. There are, unfortunately, occasions when the interests of the sales department in consumer relations overrule sound buying practice.

Wholesale Buying Practice.[1]—Wholesalers serve as the supply departments for retailers. They must buy merchandise which retailers want and at prices permitting resale by retailers at levels to yield them profits. Wholesalers may purchase from a great many manufacturers. They may in some types of busi-

[1] Beckman, T. N., and Engle, N. H., "Wholesaling," Chaps. XVII, XVIII, Ronald Press Company, 1937.

nesses carry inventories including thousands of different brands of merchandise. Since their profit margin is extremely small, mistakes in buying may be so serious as to jeopardize the profits of the concern. As in the case of the purchasing activities of manufacturers, the purchasing agents serving wholesalers are skilled buyers. They know what they want. They know the movement of prices. They are, however, faced with greater difficulties than are some manufacturers. They are nearer consumers. They must think constantly of the vagaries of consumer demand which will make themselves felt in retail stores and will be reflected in the purchasing policies of retailers. Wholesalers must constantly examine the current purchases of retail stores to notice fashion trends, buying habits, consumer reactions to price levels, and the growth and decline in popularity of different types of merchandise. Their concern with retail buying habits is much more direct than is the concern of the purchasing agent of a manufacturer who is buying raw materials and semifinished parts not for resale but for use in the manufacture of predetermined articles.

One of the major problems of the wholesaler centers around inventory control. Serving as the supply house for his retail customers, he must carry adequate stocks of merchandise or cease to perform his function satisfactorily. If he permits his stocks to become too large, however, he assumes risks of price change, style shift, and merchandise deterioration[1] which may endanger his normal profit. A carefully plotted business program and a detailed operating budget covering reorder points and size of order are necessary to control the complex inventory of the average wholesale concern.

The wholesaler has one safety outlet not possessed by the retail buyer. The wholesaler is serving a great many retail stores. If he makes a mistake in buying he is reasonably sure of being able to dispose of that merchandise, possibly at a price concession. The mistakes in buying made by a retailer must be disposed of within that one store, unless the store is associated with others in a chain. Even more than the wholesaler, therefore, the retailer must guide his buying by the frequent shifts and changes of consumer taste. The risks brought about by these frequent

[1] Deterioration may be due to physical changes in the goods, or it may be due to changes in style affecting those goods.

changes in consumer buying habits are, of course, greater when the merchandise sold is subject to rapid style obsolescence.

Problems of Merchandise Selection.—The fundamental function of the retailer is to assemble a variety of merchandise for the convenience of his customers. The task of selecting that merchandise, therefore, rests securely upon the foundation of analyzing and determining consumer demand. In some instances it may be necessary merely to supply an existing demand. For example, a consumer may walk into a grocery store and request a brand of canned peas which the merchant does not carry. If a number of customers request this brand, he may be induced to purchase the brand from his wholesaler. To be sure, he incurs some risks. The inquiries may be misleading, and they may represent merely the casual requests of a few customers. He may purchase too much of this brand of peas. But on the whole his risk is small.

In selling fashion merchandise the retailer incurs a further risk. He must anticipate consumer demands. The buyer for the women's dress department in a department store often faces this type of situation. Certain styles of dresses are being offered by the manufacturers for the coming season. The styles are new and have not yet appeared in the stores in his city. His customers are not yet wearing the new styles, but manufacturers are showing them in their sample rooms. The buyer knows that not all the styles will be popular. Out of the hundreds of styles offered by dress manufacturers only a few may ever achieve great popularity. Which of the styles offered should he buy? In each style, how many dresses? How many of each color? How many of each material? How many of each size? His records may supply him with information about the sizes preferred by his customers; they tell him nothing about the new styles.

He may consult the publications which specialize in reporting style news in manufacturing and designing circles. He may find out what styles are currently popular in such style centers as Paris, New York, Hollywood, or the leading Southern resorts. He may consult manufacturers to find out what other store buyers are considering for their purchases. He may examine the newest offerings in the exclusive specialty stores in his own city, since the newest styles will appear at high prices and will be sold first to women of the highest income group who

purchase in the leading specialty stores. But even after he has assembled all this information his final selection will depend to some extent upon his own shrewd estimate of the potential popularity of the various styles offered by manufacturers. If he buys well, the right styles, in the right quantities and the right colors, he will have a successful season. If he buys poorly, the wrong styles, in the wrong colors and in the wrong quantities, he will have a disastrous season. He will be forced to take markdowns in order to dispose of the dresses, and his department will suffer a serious loss.

The retailer must cope with all these risks. He must deal with the salesmen sent out by manufacturers and wholesalers and select among their offerings that merchandise which his customers will purchase. He must consider the potential effect of national advertising upon the buying habits of his customers. He must consider merchandise purchased by competing stores. Continually he must watch his own stocks of merchandise to make certain that he does not carry style goods past the peak of their popularity but sells them out while there are still consumers to make purchases. Yet he must be careful not to be out of stock when consumers request merchandise still in popular demand, because customers will transfer their trade to other stores where their demands can be immediately met.

Group Buying.—In making purchases large retailers possess certain advantages. They buy in large quantities; they may secure extra discounts as a result of their large purchases; they may be able to employ more skillful buyers. On the other hand, small retailers are frequently in closer touch with their customers and know exactly what their customers want to buy. The small retailer may protect himself against large retail outlets by joining with other retail stores in group-buying procedures. This practice enables small retail stores to pool their purchases and so to secure many advantages normally possessed only by the large retail outlets. The same group-buying procedure may be commonly practiced by department stores and other large-scale outlets.[1]

The stores secure whatever benefits in the shape of price concessions accrue from placing large orders with manufacturers.

[1] The role played by the resident buyer in the group buying process is described in Chap. V.

In addition, they secure a consensus of the best judgment of a number of store buyers who may thus avoid the common mistakes which may be made by a single buyer operating alone. Sometimes the stores in the group, as a result of a combined purchase of this sort, may be successful in securing from the manufacturer an agreement to confine the merchandise to the stores in the group, or, at least, to these stores in the cities in which they are located. Style confinement protects the group stores from price competition with other stores in their cities selling similar merchandise.

Group buying has become more common in recent years, but many stores still refrain from entering into group purchases, particularly in buying merchandise with a rapid rate of style obsolescence. Buyers for these stores point out certain limitations to the group-buying procedure. Not all stores require or should profitably purchase the same merchandise at the same time. Frequently it is difficult to secure an agreement among the various buyers in the group. Occasionally one buyer with an unusually aggressive personality may dominate the group and force his selections upon the others. With all its limitations, however, group buying is proving itself a successful method of purchasing staple and semistyle merchandise and has frequently been used successfully in the purchase of high-style merchandise.

The Technique of Buying.—The technique of buying includes all the elements of a major business problem. Successful buying may be the single factor necessary for marketing success;[1] failure in buying may make it impossible to earn profits. To assist the businessman to buy successfully, a great many mechanical and statistical aids have been developed.[2] Some of these, as well as a great many buying practices which are common to every type of buying procedure, will be discussed in the following pages. They are found most commonly, perhaps, in buying practices for retail stores, but these practices or similar practices may also be encountered in every part of the world of distribution.

The first source of buying information is usually sales records. The careful buyer for a retail store or for a wholesaler maintains records of merchandise sold. He keeps these records, not only

[1] The old adage says, "Goods well bought are half sold."

[2] Barker, C. W., and I. D. Anderson, "Principles of Retailing," pp. 104–113, McGraw-Hill Book Company, Inc., 1935.

in dollars, but usually in physical units. The buyer for a shoe department in a department store has sales records which tell him every day, if necessary, how many pairs of shoes have been sold, at what prices, styles, colors, materials, and sizes. These records are maintained continuously so that the buyer is able to compare recent experience with the sales records of the more distant past. In that way he can trace the rise and decline in popularity of styles and colors. He can notice any changes in consumer demand for merchandise at different prices, and he has before him a continuous picture of consumer demand as expressed concretely in terms of sales.

A second aid to buying is the use of "want slips." In most stores it is the practice for the management to require the clerks to make a note of customer requests for merchandise which the store does not carry in stock. By examining these want slips, the buyer may ascertain consumer demand for merchandise he has not yet purchased for his department. Want slips are frequently a valuable source of information on the trend of customer demand. They may indicate the growth in popularity of a new style or the willingness of consumers to purchase a color which has not previously been popular.

Valuable adjuncts to the records of sales and "want slips" are accurate inventory statistics which tell the buyer at all times exactly what merchandise he has in stock in his department. In this way he knows not only what customers are buying, but also what they are not buying. Relying upon sales records alone, the buyer may not be aware of the unpopularity of certain styles or colors or price lines. But records of merchandise inventory, when maintained continuously, at once reveal to the buyer the presence in his stock of merchandise which has not sold in volume for a substantial period of time. He may then take action to dispose of that merchandise quickly. More important, he will not repurchase such merchandise, because he knows that his customers have not been buying it in any volume for some time.

Stockkeeping records of this sort, which tell the buyer what he has in stock, what is selling, and what customers are asking for which he does not carry in his inventory, form the basis for skillful buying. In a small store such records may be very few. The buyer may be able to carry much of this information in

his head. In a large retail store these records must be kept on paper and may become very elaborate. In a wholesale house which handles thousands of different items similar elaborate records must be maintained in order to keep in stock merchandise wanted by retail customers, in order to have the capital of the business invested only in merchandise which will sell, and in order to buy intelligently in such a way as to insure a rapid turnover of merchandise. The purchasing agent for a manufacturer, unless he is buying only a few items, also must rely upon statistical aids for information relevant to successful buying.

Additional controls have been developed to assist the buyer. At the present time the use of budgets as a guide for buying[1] has become widespread throughout the business world. Budgets which place dollar limits upon purchases do not form rigid guides against excessive buying. Intelligently used, they serve as warning signals. The more successful exponents of budgetary practice do not adopt budgets and adhere to them no matter what the business situation may be. Rather their process is to adopt a budget and adhere to it unless good reason can be offered for changing the budget. Budgets should be flexible, not rigid. When used in this way, as flexible guides for purchasing, they provide one more statistical aid to assist buyers.

With all these mechanical and statistical aids, however, buying still remains in large part a problem for individual judgment to solve. Consumer demand is a tenuous thing. It changes. It is flexible. It is not the same in all parts of the country at one time. It may vary even within one city or town. It is not the same for consumers of all ages or for consumers in all income classes. The mechanical and statistical aids which have been described are helpful. Used alone without the guiding hand of a skilled buyer, they will not produce successful purchasing. They must be used intelligently. They must be adapted to the needs of the individual buyer. They must be sufficiently flexible to provide needed information at a low cost, not to serve as immovable limits to buying.

The Style Cycle.—One of the major problems with which many buyers have to deal is that raised by the style cycle.[2] For a

[1] Barker and Anderson, *op. cit.*, Chap. XIII.

[2] Paul H. Nystrom has defined style as "a characteristic or distinctive mode or expression, presentation or conception in the field of art." "Eco-

great many types of merchandise sold to consumers there seems to be a clearly marked cycle of style.[1] A style is introduced. At first its popularity is very slight. In the case of a dress, only a few women, perhaps those of the highest income class or those whose profession frequently puts them in the public eye, purchase the new style. It may be shown only in a few high-priced specialty stores. After a while the style may become more popular. Style leaders are seen everywhere wearing it. Manufacturers of lower priced garments copy the style. It is offered for sale first in high-priced department stores and then in medium-priced department stores. Women in the middle-income class purchase the style. If it is very popular, it may be seen everywhere. As time proceeds, however, still other manufacturers copy the style. It is offered for sale in low-price stores, in basement stores, and in small towns. The most conservative women as well as women in the lower income group purchase it. By this time the style leaders who first helped to make it popular are no longer wearing it because they are usually not willing to appear in styles which are being widely copied at lower prices.

This progression has become known as the style cycle. Some writers have traced the cycle from the high-price specialty stores down through department stores to the basement stores. Others have traced the cycle from customers in the higher income class through the middle-income group down to the lowest income group. Others have traced the cycle from such style centers as Paris, New York, or Hollywood through the larger cities of the country into the small cities and towns located far from style centers. Undoubtedly all these explanations have some truth in them. The style cycle has been considerably shortened in recent years by the widespread popularity of such style disseminating media as motion pictures and popular magazines.

Not all types of merchandise sold to consumers have style cycles which cover the same period of time. The normal style cycle for a dress may last from 2 to 6 months or even a year. The normal style cycle for women's hats may run during a period of not more than 4 or 5 months. The style cycle for furniture

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nomics of Fashion," p. 3, Ronald Press Company, 1928. When a style is widely accepted it may be termed a fashion.

[1] *Ibid.*, Chap. II.

is very slow; it may last for several years. The style cycle for men's clothing is slower than that for women's clothing. But whatever the time period involved may be, for practically all consumers' merchandise which is not of a strictly staple character, a style cycle may be discovered. Buyers who handle such merchandise must buy with the style cycle in mind. They must carefully judge their position in the style cycle and merchandise their departments accordingly. To assist them, elaborate machinery has been set up for forecasting fashions. Not only does the buyer rely upon trade reports and upon the observations of trade magazines to tell him what is being sold or used in the leading style centers. He also observes what is being worn and used in his own city. He must keep an eye on the offerings of his competitors and upon the displays of those stores in his city which are leaders in offering new styles.

Not only must the buyer be aware of the style cycle for the merchandise he handles; he must also bear in mind the seasonal shifts in demand which may affect the sale of the merchandise he carries. He must be alert to every possible change in the demands of his customers. He must be prepared to forecast price movements which may have a serious effect upon the cost of the merchandise he purchases. At times, as a result of his estimates of future price movements, he may prefer to buy only to meet his immediate needs. At other times, forecasting a long rise in prices, he may be induced to advance his purchases beyond his immediate merchandising needs in order to benefit from the price rise which he foresees. Such a policy, of course, is accompanied by great risk. Not all buyers act in this way. It is, indeed, the policy of many stores never to make future commitments which carry with them the danger attached to speculation based upon future price movements of merchandise.

Summary.—It should be obvious that, although a great part of this discussion has been phrased in terms of the problems of a retail-store buyer, most of the difficulties are similar to those which must be faced by every type of business purchaser whether he serve a retail store, a wholesale house, or a manufacturer. Each purchaser is concerned with the buying habits of that group of individuals which forms the body of his customers. They all have similar problems, and for each one the importance of successful buying is framed by the direct relation between good

buying and profits. The emphasis is placed upon the retail buyer, however, because of his direct contact with the vagaries of consumer demand. The problem of deciding what to buy, when to buy, and how much to buy, like many other problems in marketing, begins with the consumer and works back through retailer, wholesaler, and manufacturer.

CHAPTER XII

TRANSPORTATION AND STORAGE

"The magnificent transportation system of the United States has been the single most important influence in guiding the growth of our distributive process."

"What we have done in marketing has been accomplished in spite of an ineffective and inefficient transportation system. Water, rail, and truck freight movements are wasteful and uncoordinated. Transportation facilities and crosshauls raise costs. Adequate terminal facilities are available only in a few cities."

"Storage functions to put merchandise into bank vaults by proxy. It can therefore be regarded as self-financing, self-liquidating, and self-supporting."

TRANSPORTATION

The Web of Transportation.—California oranges are sold in New York. New York clothing is sold in Florida. Florida grapefruit are sold in Chicago. Chicago meat is sold in Virginia. Virginia tobacco is sold in Oregon. Over 29 billion dollars is invested in rail, pipe-line, truck, and waterway transportation in this country. In 1937 the freight traffic carried by American railroads exceeded 360 billion ton-miles. In the same year passenger traffic amounted to more than 410 billion passenger-miles.[1] Even such astronomical figures fail to give a satisfactory picture of the way transportation is bound up with distribution, carrying the merchandise of our farms, mines, and factories to distant markets.

The weaving of this web of transportation has been in part the product of the industrial revolution, which made possible the application of power techniques to the movement of men and freight. In part it has also been the result of the problems of industry and population which have arisen under conditions of modern living. Giant industry must have giant markets.

[1] An interesting graphic and statistical story of the railroads is presented in "A Yearbook of Railroad Information," 1938 ed., published by The Committee on Public Relations of the Eastern Railroads.

Giant markets can seldom be found immediately adjacent to giant industry. The search for giant markets and the attempt to satisfy the wants of giant markets has made it necessary to build a system which can insure that these markets will be continually supplied with the merchandise which they need. In response to this need the transportation system of this country has developed. Whether or not it is efficient may be judged, perhaps, only on a relative basis. Some understanding of the part which transportation plays, some knowledge of the share of marketing costs which are accumulated by transportation of merchandise, some insight into the problems of transportation and the services supplied by transportation are necessary in order to form any judgment about its value.

Under conditions of modern marketing, transportation is the determining factor in limiting the extent of the markets in which merchandise can be sold. Within those market areas the efficiency of the transportation system further determines to a large extent the price schedule of merchandise. It also assists in the determination of the use of substitute types of merchandise. In many cases, for instance, transportation is the single factor which determines whether in any community coal or oil will predominate as a household fuel. Transportation may also point the need for and assist in the location of warehouse facilities, and it may be an important influence in the determination of plant location.[1]

Factors Determining the Efficiency of Transportation.—The efficiency of transportation may be described as the end product of service and cost. It cannot be measured either on the basis of cost alone or on the basis of service alone. Excellent transportation service may be so costly as to limit the market in which merchandise can be sold. Cheap transportation may be so inefficient as also to limit the market within which merchandise can be sold. Even total transportation costs do not offer a reliable index of transportation efficiency inasmuch as marketing practice to a large extent depends, not upon total transportation costs, but upon relative transportation costs, *i.e.*, the compara-

[1] Malott, D. W., "Problems in Agricultural Marketing," pp. 289–298, McGraw-Hill Book Company, Inc., 1938.

Locklin, D. P., "Economics of Transportation," Chap. VI, Business Publications Inc., 1935.

tive costs of transporting competitive products. This is certainly true in so far as the rates are applied to products which may be used interchangeably as universal substitutes, as are oil and coal.

In oil-coal competition for satisfying the fuel demand of an urban market, it is not the dollar cost of transporting either fuel to the market which determines the choice of fuels in that market. It is the final price to consumers. The final price is not set by transportation costs alone. It is determined by the combination of production costs, transportation costs, and marketing costs.

The instances of such relative transportation costs have been important factors in the location and developing prosperity of our large cities. The central location of Chicago as the logical center of a web of railroad lines has been among the dominating influences shaping its growth in size and industrial importance. Throughout the development of American urban communities businessmen have recognized the directing influence of transportation. The history of metropolitan growth in the nineteenth century is marked by a series of economic struggles between cities for control of transportation facilities. Those communities which lost out have tended to decline in size and economic significance. Those which won are now the country's leading cities.

The study of transportation costs should be directed, not only to the relative costs of moving various types of merchandise over our railroads, but also to the comparison of freight costs for railroads and for other types of transportation facilities capable of handling freight. The web of transportation on which marketing depends is no longer one of railroad transportation facilities alone. Motor trucks have assumed an increasing share of the transportation business. Water transportation has always been an active competitor in serving many seaboard and inland markets. Even air transport is beginning to enter the freight business for certain types of merchandise.

The union of freight rate and freight service may be termed the efficiency factor in freight movement. To take a simplified illustration, consider the problem of selling in a Midwest city fruit raised in both Florida and California. Competition between producers for that market is based, not only on the taste and appearance preferences of consumers in the city, but also

on competitive retail prices. Freight rates are an important influence in the determination of retail prices for perishable food products. Producers, in considering the competitive possibilities of selling in that market, must deal with both railroad freight rates and with the potential use of trucks for moving the fruit. In seaboard markets there may be a further problem revolving around the use of water transportation for all or part of the distance.

One characteristic of freight rates which closely resembles a characteristic of prices is worth noticing. If two automobiles in the same price class are sold in the same community, they will share the potential sales volume in a way that reflects consumer brand preference. Now let us suppose that the price of one of the cars is reduced $100 with no decrease in quality. Sales of that car will increase markedly. But more important, sales of the competing car will probably be affected adversely. When two products compete for a market, price changes for one affect not only the sales volume of that product, but also the sales volume of the competing product. Price changes of this sort are like changes in freight rates. If California and Florida oranges compete in a Midwest city, freight rate changes for oranges from either state will affect the sales of oranges grown in both states. A shipper has an enduring interest, therefore, in freight rates for his own products and in freight rates of all competing products.

The ideally efficient transportation system, then, is that one which moves the country's freight at a minimum cost and with adequate service; it is that one which opens the most distant markets to the products of factories and so assists in securing the economies of mass production. With the complex of freight rates which now exists in this country and with the existing confusion of cross-freight movements,[1] it is impossible to say that the American transportation system is at a high level of efficiency. It has served to open distant markets to merchandise, however. It has grown with the needs of the American market. It has made unusual adaptations to the problems of moving

[1] Movements of similar merchandise in opposite directions so that shipments cross each other. Assume that similar products are raised in area *A* and area *B*. Produce from *A* may be shipped to *B* or near it, and produce from *B* may be shipped to *A* or near it.

perishable merchandise. As a number of writers on the subject have pointed out, a great part of the present difficulties in transportation depend for their solution upon the development of a more integrated transportation system. To the extent that the movement of freight is expedited by this or other means and the efficiency of the service thereby improved, consumers will receive direct benefits. Retail prices will reflect reductions in transportation costs. The volume and variety of merchandise offered to consumers will increase.

The Railroad Plant.—The railroad plant is a combination of tracks, equipment, and terminals which function together to provide freight service. The effective coordination of the separate parts of the railroad plant is necessary in order to guarantee uniform and efficient service at a low cost. At the present time it can safely be said that the railroads have a sufficient amount of both track and equipment and that, in so far as the plant is weak, it is in terminal facilities. It is true, of course, that in the years of depression which followed 1930 railroad equipment suffered from decreased appropriations for maintenance. The real failure of the railroads as freight forwarders, however, may be said to lie in the provision of modern terminal facilities. Many of the costs of railroad transportation are incurred not when freight is moving but when freight is standing still. Delays of this sort arise because of difficulties of coordinating shipments and more particularly because of the lack of adequate terminal facilities for expediting the handling of freight. It has been estimated that only one-tenth of the useful life of a freight car is spent in actual productive freight movement. The balance of the time is spent in switching, loading, unloading, and making repairs. Terminal facilities, therefore, may be said to be the heart of the railroad transportation problem.

Modern freight movement requires terminal facilities adapted to handling large volumes of freight under conditions of constant pressure for speed. A great deal of time and expense is necessarily involved in loading and unloading freight cars, in switching cars, and in making up trains. The concentration of large consuming markets in our major cities has served to intensify the already difficult problem of congestion because of the necessity for assembling daily the tremendous quantities of freight required for the successful maintenance of urban life. Much of this

freight is perishable and needs, if it is to reach its market in good condition, the swiftest possible handling. Part of the congestion, of course, is due to the free and unplanned way in which our major cities have grown. Another part, perhaps, is due to careless location of terminal facilities or to the subordination of the needs of freight terminals to real-estate considerations. In many cities the high value of desirable real estate has prevented the railroads from making the necessary expansion of terminal space. As a result many of our leading terminals are bottlenecks which hamper and delay the swift distribution of merchandise.

Improving Transportation Services.—A number of remedies have been proposed for the relief of the terminal problem. These include improved mechanical devices for loading and unloading freight cars, more successful handling of freight cars in railroad freight yards, and recently, the use of trucks to expedite the handling of l.c.l.[1] freight in congested districts. The transfer of a substantial proportion of the short-haul business from railroads to trucks has also contributed in some measure to the relief of the congestion problem. This, of course, has been at the expense of freight volume, so that it adds to transportation costs through increased overhead expenses. Other possible remedies may lie in further electrification of the railroads, or in the extended decentralization of industry which would help to reduce the concentration of freight movements in a few terminals. It would be a serious mistake, however, to overlook the immediate need for more terminal space and tracks or to underestimate the difficulty of satisfying these requirements with existing high real-estate values.

Another recent undertaking of the railroads has been the widespread use of store-door deliveries. The practice of employing trucks to collect freight at the shipper's door and move the merchandise to the railroad terminal and again to move freight from the terminal to the receiver's door has long been in use in both England and Canada and in certain American cities. Recently it has been extended by the railroads, particularly under the impetus of truck competition. The innovation provides faster service for shippers and aids in more rapid handling of freight at terminal yards. In addition, it makes it possible to locate terminal facilities at points distant from the business

[1] Less than carload.

sections of our major cities. If any extensive movement of terminal facilities can be brought about in this way, the lower real-estate values away from the central areas may make it possible to wipe out the bottleneck conditions existing in many cities.

It should be noted, on the other hand, that not all freight shippers prefer store-door delivery. The limited period of freight storage in freight terminals permitted shippers by railroads[1] has often been a convenience to shippers. Store-door delivery may cut down the time during which freight may stand idle at no expense to the shipper. Those shippers who maintain their own delivery equipment may also find reason to object to the railroads' innovation. The practice is on the increase, however, and has been particularly successful in drawing to the railroads the l.c.l. business which has been an expensive method of shipment.

The handling of l.c.l. freight has also been aided by the use of freight containers. The freight container is a large steel bin which may be loaded or filled at the warehouse, hauled by truck to the railroad freight terminal and placed on a flat car. The use of this equipment may be instrumental in reducing handling and crating costs, in speeding up handling, and in eliminating loss by theft.

Tariffs and Classifications.[2]—The rates at the present time are published and all shippers have access to rate schedules. The determination of specific railroad freight rates is a complex problem. The rate differs for each class of products carried.[3] It is the result of a complex of factors which may include such

[1] After a certain period, usually 48 hours, the railroads levy a "demurrage" charge for each day the shipper fails to take his merchandise. This charge is not primarily to give the railroad revenue but is to penalize the shippers for not taking their merchandise.

[2] Locklin, *op. cit.*, Chap. VIII.

[3] "Freight classification is the grouping of thousands of commodities into a limited number of classes for the purpose of rate making. A freight classification is an alphabetical list of articles together with the 'rating' which each commodity takes. The 'rating' is the class or group into which the article is placed for the purpose of quoting freight charges. The rating should be distinguished from the rate. The latter is the charge, usually in cents per hundred pounds or per ton on the commodities and classes of commodities. The classification gives the rating; the freight tariff gives the rate."—Locklin, *op. cit.*, pp. 162–163.

considerations as the value of the product, its physical characteristics, the competition of other forms of transportation, the cost of providing the service involved, and an estimate of what the traffic will bear. The last point refers to the amount of rate burden which a product can assume without having its price driven to the point where consumer demand declines. It has long been a determining factor in railroad freight charges. Rate schedules provide both carload and l.c.l. rates for all classes of commodities moving between different points.

Transportation and Marketing Methods.—The influence of transportation upon marketing methods is shown most clearly by the difference between carload and l.c.l. rates. The rates charged for shipment in carload lots are lower than the rates for similar products shipped in smaller quantities. This rate differential is a natural one because it costs less to handle, load, and unload merchandise which is shipped in carload lots. The attempt to realize savings in transportation charges thus takes shape as an effort to move carload lots intact as near to the consumer as possible before breaking up merchandise into small shipments. This is one of the major forces supporting the existence of the local wholesaler. The manufacturer realizes a saving by shipping carload lots to local wholesalers for distribution to retail stores in l.c.l. shipments. The rate differential is also one of the prime influences in developing the practice of concentrating farm products. The concentration process makes it possible to move freight from country concentration points to major central wholesale markets in carload lots rather than in l.c.l. shipments.

A large proportion of the total freight movement, however, must continue to be transported at l.c.l. rates. Among the attempts to improve l.c.l. service, particularly since the motor truck has begun to make serious inroads into railroad freight shipments, the services of the organizations known as freight forwarders have assumed importance. These independent agencies consolidate from several manufacturers l.c.l. freight moving to a common destination and ship this mixed freight at carload rates. The freight forwarders quote shippers a price somewhat lower than l.c.l. rates. They cover their expenses and secure a profit from the margin between the quoted price to shippers and the carload rates which they secure from the

railroads. They may offer store-door delivery. The shipper gets the benefit of a lower rate than the l.c.l. rate; the receiver gets faster service and, delivery at his place of business.

Among the other services offered by the railroads some mention should be made of the importance of developing union freight terminals. The union terminals with direct access to the tracks of a number of railroads provide easy switching from the tracks of one road to those of another. They may make possible a considerable speeding up of freight handling. Some cities have developed belt-line railroads which connect the rails of all roads entering the city, and which, in a somewhat less satisfactory manner, may replace the union freight terminal.

The Reconsignment Privilege.[1]—A railroad service which is being used with greater frequency in recent years is the privilege of reconsignment of merchandise. When this privilege is granted by the railroads a shipper may direct the road to change the destination of his merchandise while it is in transit. This service is particularly valuable in directing the movements of perishable fruits and vegetables. Such merchandise may be originally consigned to one large Eastern city. While the produce is in transit marketing information may become available indicating that higher prices are being offered in another market. By reconsigning freight while in transit the shipper may take advantage of this information and redirect his merchandise to the best market. Certain other commodities may be halted in transit for processing or storage.[2] These services are offered by the railroad at the regular through rate plus a small charge for the stoppage privilege. The railroads also offer refrigerator service at a higher rate which enables shippers to move perishable merchandise for long distances. The refrigeration service has greatly enlarged the marketing areas open to shippers of perishable fruits, vegetables, meat, and fish. It has changed the eating habits of the nation, giving us a varied diet of fresh products at all times of the year.

Transportation by Motor Truck.—The volume of freight transported by motor truck has increased rapidly in recent years. At first, motor trucks assumed the burden of moving freight to

[1] Also called "diversion in transit."

[2] Cattle may be stopped in transit for feeding.

and from railroad freight terminals. Later, they began to assume a greater part of the burden of moving l.c.l. freight over short hauls. At the present time they move a substantial proportion of all l.c.l. merchandise. They have even begun to compete with the railroads on long hauls. In some cases they are handling long-haul freight movements even where rail movements would appear, on the surface, to be cheaper. The motor truck eliminates repeated handling of goods and also lessens the need for crating certain types of merchandise. The problem of rail-truck competition is still obscured by the absence of definitive information on the comparative costs of moving freight by the two means of transportation. The division of freight shipments between railroads and motor trucks has not yet been clarified on the basis of competitive rates. The extension of Interstate Commerce Commission control over motor-truck freight rates may change the present division of freight movements. A closer analysis of competitive costs of freight movements of these two types of carriers may also bring about a realignment of the division of freight shipments. In the long run, motor trucks may come to handle the bulk of short-haul freight movements extending up to about 200 miles. The railroads may continue to move freight for distances of more than 200 miles. For longer hauls at these distances the time and expense of handling freight between shipping and receiving points and freight terminals may be balanced by the lower costs of moving carload freight over great distances. Truck service, on the other hand, is more flexible, in many cases more convenient, and for short hauls or for the movement of perishable merchandise may be swifter.

Water Transportation.—The movement of freight by water competes to some extent both on the seacoast and on the rivers and lakes with the movement of freight by land. A number of obvious comparisons can be pointed out. Water transportation is slow; it is cheap; it is not adapted to the handling of perishable merchandise; it cannot serve all markets. Shippers of bulky nonperishable merchandise often resort to coastal, lake, or river transportation rather than rail transportation. Bulky raw materials are frequently moved by boat. Speed of delivery is not important, and the low rates compensate for the

bulkiness of the merchandise which would incur very high transportation costs if moved by rail.

As has been indicated with reference to rail transportation, the movement of freight by water, the availability of suitable harbors with equipment for handling freight, and the integration of rail, truck, and water freight facilities directly influence the location and importance of our leading cities. The influence extends beyond the immediate boundaries of metropolitan areas to all the territory economically dependent on the central city. The claim has even been advanced that the availability of cheap water transportation between the West coast and the East coast has measurably aided in the industrial development of these regions, to the detriment of the inland areas of the country.

Air Transportation.—In recent years air express, estimated to be three times as fast as any other means of shipping, has been resorted to by shippers of merchandise of high value which requires great speed in transit. The types of merchandise which can be moved by air are obviously limited. This method of transportation, however, will probably be used increasingly in the future for rush orders of highly perishable luxury merchandise, for repair parts, and for similar merchandise.

Government Regulation of Transportation.—Freight rates are subject to regulation by governmental authority. The general theory of applying government regulation to an industry containing the germs of monopoly and affected with a public interest has been followed in determining the direction, extent, and severity of regulative acts. Regulative authority has extended beyond the supervision of freight rates and has embraced the capital structure, the extent of competition, the earning of profits, questions of consolidation and control, labor engaged in the transportation industry, and the liquidation and reorganization of common carriers. Numerous governmental agencies participate in the regulative process. Among these agencies may be included the Federal and state legislatures, the Interstate Commerce Commission and the various state commissions and Federal and state courts.

The Relation of Transportation to Marketing.—The way in which transportation facilities shape and influence the entire structure of marketing cannot be overemphasized. Not only

does transportation limit the areas within which products can find purchasers; it also affects competitive costs and retail prices of merchandise. Within one city the supply of transportation facilities may help to determine the location of terminal markets, of manufacturers' plants, and of wholesale houses. In addition, transportation facilities for consumers play a large part in determining the location of major shopping areas. They may assist in the growth of suburban shopping areas and may indirectly affect the trend of retail trade over large areas. We have already pointed out that for a great many products transportation costs amount to as much as one-half of final retail prices. Even where they bulk less in total retail prices, their influence may be responsible for the selection of channels of distribution and for the organization of marketing procedure.

STORAGE[1]

Why Merchandise Is Placed in Storage.—Like transportation, storage may be regarded as a function necessary to the efficient performance of the distribution of merchandise. If merchandise were used by the consumer immediately after it was produced, there would be an uninterrupted flow of goods which would make the storage function unnecessary. But merchandise is not produced or manufactured simply to meet current needs. Frequently it is produced far in advance of the needs of consumers. At times this may be done consciously by the producer, but at other times he may have no choice. Some merchandise may be produced seasonally and consumed regularly all the year around. Many types of farm products fall into this classification. Other types of merchandise may be produced all the year round but have only seasonal consumption. A great many manufactured goods fall into this classification; perhaps such articles as winter and summer sportswear are outstanding. Still other types of merchandise, such as natural ice, may have both seasonal production and seasonal consumption, but the seasons may not correspond. The seasonal nature of transportation may necessitate storage. Since navigation on the Great Lakes is stopped during the winter months, enough coal and iron ore must be stored to last over this period.

[1] Haring, H. A., "Warehousing," Ronald Press Company, 1925.

At times it may become desirable to store merchandise for speculative purposes in anticipation of a price rise. Many wholesale and retail buyers of consumers' goods from time to time find occasion to purchase in advance of current needs to take advantage of favorable prices. For the same reason manufacturers may buy large quantities of raw materials. As a result, they are forced to store merchandise for some period of time. Some types of merchandise, indeed, require storage for conditioning. Tobacco, cheese, and whisky may be typical of this class of goods. Almost everywhere in the marketing system some storage is required as a protection against delayed shipment. Where transportation over considerable distances must be undertaken exact connections may not always be arranged and storage may be necessary while merchandise is waiting for adequate transportation facilities.

In economic terms, therefore, we may think of storage as creating a time utility, by preserving goods from the time they are produced until the time they are consumed. Storage thus assists transportation in broadening markets and in adjusting inequalities of supply and demand in different localities. As a result of storage there is a smoother flow of merchandise into the hands of consumers and violent price fluctuations are appreciably modified.

Storage Agencies.—At the present time we can distinguish a number of different types of storage warehouses. There are private warehouses, *i.e.*, the space used by individual business concerns for the storage of their own products, either before or after manufacture. There are bonded warehouses operated either directly by the government or under its license. There are custodian or field warehouses, a term referring to a section of a building, primarily used for other purposes, set aside for the storage of surplus merchandise and placed under the control of persons other than the owner of the goods. The main object of custodian warehousing is to permit the owner of the goods to get warehouse receipts from the custodian without sending his goods to a public warehouse. He then may use these receipts as collateral for loans. Last of all, there are public merchandise warehouses, perhaps the most common throughout the field of marketing. The public merchandise warehouse represents the mature development of the warehouse business operating a

specialized type of service, providing convenient and safe storage facilities, insurance against loss from various risks, and an organization equipped to handle freight as economically and speedily as possible.[1] Public merchandise warehouses also serve a further function by issuing receipts against merchandise deposited in the warehouse. The receipts may be made in negotiable form and provide excellent collateral for securing loans. The warehouse receipt, in fact, has come to be one of the most frequently used financial instruments.

The services of public warehouses have been developed to such a point that they act as centers where a number of marketing functions are performed. They should not be considered merely as points of storage. They may repack and reship merchandise, divide up carlot shipments into l.c.l. shipments, or gather small shipments into carlot shipments. If a manufacturer stores merchandise in a warehouse he may use that warehouse almost as a branch of his own business. He may transmit orders to the warehouse to ship merchandise, and that merchandise will move following his orders in small lots to his customers. The importance of warehouse receipts in furnishing a secure basis for collateral cannot be minimized. Many of the funds which support the marketing of our basic agricultural crops are secured by loans based upon warehouse receipts. The protection which public merchandise warehouses offer to lenders provides ample security for the extension of loans covering the marketing of the major agricultural crops.

Storage and Prices.—Storage has a direct influence upon prices. Retail prices must, of course, cover the cost of storage; but, beyond this, the comparative costs of marketing a commodity through this channel or that channel and of marketing with or without the assistance of public merchandise warehouse service may determine the limits of marketing areas within which a product may be sold. As in the case of transportation, these comparative costs may also determine the availability of substitute products within the marketing area and the level at which retail prices will settle.

The major function of storage with relation to price movements may be described as that of serving as a stabilizing factor.

[1] Haring, Albert, The Public Warehouse; An Essential Tool in Wholesale Distribution, *The Journal of Marketing*, October, 1936, p. 106.

Storage serves to equalize supply and demand by carrying merchandise from periods of glut to periods of dearth. The equalizing of supply and demand in this way helps to prevent pronounced price fluctuations. Whenever the costs of storage are less than the losses which might be suffered by selling in a depressed market, the producer may prefer to withhold his merchandise from sale and pay storage costs until the market price rises.

CHAPTER XIII

FINANCE

"Credit flows through marketing like oil through an engine."

"The dangers of easy credit have not been given sufficient emphasis. Many of our economic ills might be reduced if the principle of 'I pay cash' were extended throughout distribution."

Dependence of Marketing upon Credit.—Credit is the silent invisible lubricant of distribution. Without credit, goods would move more sluggishly to market; the areas within which they could be sold would be limited, and the supply of merchandise to consumers would be erratic and nonpredictable. It is not difficult to imagine that prices would fluctuate wildly; without a supply of credit few producers would be in a position to store merchandise in the attempt to equalize supply and demand at various points and at different times of the year. Without credit, indeed, the business world would not be the business world we see around us. Credit, however, seems both silent and invisible. Where does it come from and why? Who supplies it? Under what conditions is it made available to business? At what point does it touch marketing? How does it influence marketing? How are such activities as storage and transportation affected by the supply of credit? What is the influence of credit upon prices?

The dependence of marketing upon a ready flow of credit is distinctly a modern phenomenon. With the extension of market areas, the prolongation of marketing and productive processes, and the development of specialized agencies the demand for credit has become widespread. The common experience is that a businessman buys merchandise some time before he resells that merchandise. Without the extension of credit to carry the purchaser over the intervening period until he is placed in funds by the sale of his merchandise, it would require a tremendous amount of capital to enter business. The function of operating as a businessman would be limited to the very few who would themselves assemble sufficient funds to pay their

own way. Credit thus serves to increase competition by enlarging the opportunities of the financially weak. Credit advanced against merchandise may be truly called a foundation stone of modern distribution.

How Middlemen Use Credit.—Every agency in distribution makes use of credit. A manufacturer sells to a wholesaler. The wholesaler must hold his merchandise in stock for some time before he disposes of it to a retailer. The manufacturer finances this storage function by permitting the wholesaler to delay his payment from 30 to 90 days or longer. During that time the wholesaler will have the opportunity to sell to a retailer. The retailer may pay him cash, in which case the wholesaler has the funds to pay the manufacturer. The wholesaler, however, may choose or be forced to extend credit to his retail customer. He may still secure the funds to repay his manufacturer creditor by borrowing from a bank. The bank is willing to lend him money because he has ample security in the form of merchandise.

The retailer, in turn, unless he is very soundly financed, may be unable to pay his bills in cash. He, too, may borrow from a bank, again offering his merchandise as security. He may often be called upon in turn to extend credit to his customers. In some cases he may permit his customers to purchase merchandise and pay for it at the end of the month. In other cases he may sell upon installment terms. It is not difficult, therefore, to visualize the flow of merchandise from producer to consumer being supported and carried forward by credit. Credit serves to equalize the flow of merchandise and the flow of payments for merchandise. It may be the determining factor in a buyer's selection between different sellers. It may directly affect the cost of merchandise as well as the costs of distributing that merchandise. It permeates every phase of marketing.

The Need for Credit in Business Enterprises.—The need for credit arises from the routine operation of normal business undertakings. Such conditions as unbalanced seasons of production and use, the need for maintaining adequate working capital, and trade customs which affect the credit period extended by sellers to buyers directly contribute to the need for credit.

Farm crops offer pertinent examples of seasonal credit requirements. The bulk of the wheat and cotton crops come to market within a short time period. Before these crops have undergone

manufacture and reached consumers, however, considerable time has elapsed. Furthermore, although production is seasonal, demand continues fairly regularly throughout the year. As a result, the major part of the wheat and cotton crops must be held over and stored not only during the processing period but also to equalize supply and demand throughout the year.

Whenever merchandise must be held in storage, financing is required. Merchandise held immobile between purchase and sale simply furnishes a disguise for dead capital. Someone must supply that money which is immobilized in the merchandise. The owners of the merchandise are frequently unable to function as their own suppliers of capital. At this point there appear banks and other financing agencies which, for a price, extend the credit necessary to support the storage of merchandise awaiting further processing or sale. The explanation of dissimilar seasonal cycles for production and sale, therefore, resembles closely the explanation of the need for storage. Whenever sellers wish to dispose of merchandise at a time when buyers do not wish to buy, whenever buyers wish to purchase merchandise when sellers cannot supply it, the need for storage and the need for credit become dominant in the marketing process.

The business forces that determine the need for credit are closely interrelated. The need for credit expands in proportion to the length of the productive and marketing cycle. The longer the time period involved in producing and distributing merchandise, the greater is the need for credit. Under these conditions money must be tied up for long periods in goods, sales are delayed, and the ultimate return to the producing concern may be made a considerable time after the first and perhaps the major outlays for necessary production and marketing expenses. If, in addition to having a lengthy production and marketing cycle, a business operates under conditions of pronounced seasonal production or pronounced seasonal consumption, there may be a further need for credit. A number of American manufacturing companies, for instance, produce merchandise which can be sold only at certain periods of the year. Frequently, however, these companies find it an economical and discerning business policy to operate their plants throughout the year. In this way they secure regular use of machinery and afford steady employment to their employees. Working throughout the year, these con-

cerns accumulate large inventories of finished goods which cannot be disposed of until the buying season begins. It may prove to be impossible to induce consumers to buy out of season even at reduced prices. Under these conditions business concerns must reckon as part of their manufacturing costs the expense of providing the necessary capital for holding a large finished goods inventory.

Need for Credit in a Single Business.—If these are the general conditions which govern the need for credit in marketing, what conditions govern the need for credit within a single business organization engaged in the marketing process? Examination discloses a number of factors which directly affect the need for credit in individual business and, by extension, indirectly affect credit needs in general business.

It has already been indicated that inventories, wherever they may be found, represent engaged capital. Inasmuch as few concerns have sufficient working capital to act as self-financing enterprises, the size of the inventory of merchandise maintained by a business concern directly affects its need for credit. The greater the inventory, the more pressing the need for capital funds; the greater the need for capital funds, the more pressing the need for credit. This extension of the need for credit does not, of course, lie wholly within the control of management. The size of a concern's inventory is dictated not only by independent executive decision; it is influenced by the volume of sales, by the distribution of sales throughout the year, and by the dispersion of sales throughout the country. The relation of the manufacturing period to the size of inventory and the time period during which manufacturing occurs prior to sale also directly affect the size of the inventory of merchandise.

How Working Capital Is Supplied.[1]—Credit has a further function as the lifeblood of business by serving as the source for much of the routine working capital needs of business concerns. Few concerns are in position to supply their own working capital requirements completely. They fill out the lack by borrowing from banks or from creditors who permit them to delay payment

[1] Hoagland, H. E., "Corporation Finance," Chaps. XXIV, XXV, McGraw-Hill Book Company, Inc., 1938.

Dewing, A. S., "Financial Policy of Corporations," Book IV, Chap. II, Ronald Press Company, 1934.

of their bills. This condition is not always the result of inadequate self-financing by business. It may be the normal outcome of the business practice of extending credit to other firms. In this way, part of a firm's necessary working capital may be tied up pending the payment of bills by business debtors.

The conditions which determine a concern's working capital needs have a direct connection with credit requirements. In addition to the size of the inventory, therefore, consideration must also be directed toward accounts and notes receivable and accounts and notes payable. These in turn may be affected by terms of purchase and sale and by general business conditions.

Working capital requirements are defined by the balance of income and outgo. A company which receives immediate cash payments from its customers is in a position to pay its creditors promptly. A company which must extend liberal credit terms to its customers must either secure similar terms from its creditors or enlarge its working capital sufficiently to complete the adjustment of income and outgo.

How Strength of Buyer and Seller Influences Credit.—The length of credit terms which are offered in any industry are not determined by independent judgment. They are themselves the result of other factors. Among those exerting an important influence on credit terms may be noted the relative business strength of concerns in the industry and, at any single time, the general condition of business as measured by the fluctuations of the business cycle.

Competition between firms selling to the same industry easily passes from price and quality competition to credit competition. Concerns seeking customers often attempt to make their offerings more attractive by liberalizing credit terms. Such a condition is commonly found where competition between sellers is intense. It may be encountered in industries characterized by a large number of sellers of well-standardized merchandise.

When sellers are few and large, reverse conditions are likely to be encountered. Sellers are strong enough to dictate their own terms and competition may be less intense. Large sellers may decide to extend liberal credit terms to small buyers as a result of a decision to attempt to enlarge their markets by aiding weak purchasers. This is done voluntarily, however, and not as the result of competitive pressure.

Business-cycle fluctuations exert a similar effect upon credit terms. In times of expanding and prosperous business, buyers tend to be in a weaker position than sellers. They may be more anxious to purchase than their suppliers are to make sales. Credit terms are likely to be determined in line with the desires of sellers rather than buyers. When business is depressed and sales are hard to make, sellers compete more actively with one another. At such times credit terms tend to be liberalized in line with the desires of buyers, who dominate the marketing process.

This general situation may be summarized in the statement that one influence on credit terms is the comparative strength of buyers and sellers. Such diverse factors as business custom, the number of buyers and sellers, the urgency of their need to buy and sell, and general business-cycle conditions directly affect the competitive position of buyers and sellers.

Other Factors Affecting Credit.—Finally, a concern's credit needs are influenced by the skill and economy with which its management disposes of its available funds in relation to the demands made upon those funds. Within the control of business management may be found such problems as the adjustment of inventories to purchases and sales[1] and the adjustment of owned and borrowed capital to seasonal variations in sales. These problems are not easily solved. Whether a business should maintain a large inventory and turn its stock slowly or a small inventory and turn its stock rapidly depends on the consideration of such factors as the savings which may be secured from quantity buying and the risks of deterioration, obsolescence, and price change which vary directly with the size of the merchandise inventory. Whether a business operating under conditions of pronounced seasonal sales fluctuations should maintain owned capital sufficient to meet the peak demand or should borrow at the peak season depends on the consideration of such factors as the investment opportunities available for disposing of surplus funds in the dull season, the cost of securing financial aid at the peak and the extent to which independent financing institutions may be relied upon to supply funds when needed.

These are management problems. The skill with which business management can meet these difficulties is not the least

[1] Foulke, R. A., "They Said It with Inventories," Dun & Bradstreet, Inc., 1939.

important of the factors which influence the working-capital position.

The Supply of Credit.—As the previous discussion has indicated, the supply of credit is not limited to that offered by banks. Commercial credit[1] may be advanced by one business firm to another, or it may be secured by the pledging of securities or merchandise against a loan. As a result it is impossible to view the supply of credit as controllable at any one point. Rather, it is a medium which extends throughout marketing and the supply of which may be said to expand and contract in direct relation to the rapidity and the volume of sales of merchandise. It extends to consumers as well, particularly in the recent years which have witnessed the growth in popularity of the installment method of purchase. One may think, then, of three types of credit:[2] bank credit; commercial credit, which is extended by one business firm to another; and personal or consumer credit, which is credit extended by a business firm to a consumer.[3]

The Length of the Credit Period.—The need for credit varies in different types of business. The length of time during which credit may be made available also varies. Where a substantial period elapses between the time of the first investment of funds which must be made by the producer and the day when he turns his produce into cash, a large supply of credit is required and the credit period may be long. This is the situation in the field of agriculture. This may be contrasted with the relatively short credit period frequently required by retail stores, which often anticipate the payment of their bills to take advantage of cash discounts.

The credit period allowed by the seller usually conforms to the period during which the purchaser receives his income. In the case of sales to consumers this practice accounts for the fact that most stores extend 30-day credit. Wholesalers adjust their credit extension to retailers on the basis of the same receipt period which may vary with the type of business. Thus the rate of turnover of the buyer's stock is the fundamental factor

[1] Also spoken of as "mercantile credit."

[2] Beckman, T. N., "Credits and Collections in Theory and Practice," Chaps. III, IV, V, McGraw-Hill Book Company, Inc., 1938.

[3] The various ways in which a consumer may get credit are discussed in Selling Credit to Consumers, *Consumers Guide*, January 30, 1939, p. 11.

influencing the determination of the credit period. Other considerations may modify this calculation. They include the location of the customer, transportation facilities, the credit period offered by competitors, the nature of the risk involved in extending credit, business custom in that territory and of the particular trade involved, the state of the business cycle, and the credit period granted by preceding or alternative sellers.

These general limitations on the credit period are set up in part by the credit offers of competing firms. Action by one seller to restrict terms may divert trade to other sellers as quickly as the attempt to maintain for competitive merchandise a price above the competitive level. In part, the credit limitations may be dictated by the conditions of business. During a period of increasing prosperity, sellers may dominate the marketing process. Credit terms are not under pressure, and the credit period in many lines may be short. During a period of depressed business, buyers may dominate the marketing process; sellers may compete for a shrinking volume of trade; credit terms may be used as a device of competition and may be liberalized in the attempt to attract buyers.

After he extends credit to his customers the seller of merchandise often finds it necessary to secure credit for himself. His customary recourse is to his bank where he may obtain a direct loan either secured or unsecured. So it is that a part of the working capital of almost every business firm is supplied by other business concerns or by banks.

Why the Seller Desires to Pay Cash.—One of the reasons for turning to banks for short-period financing is the desirability of taking the cash discounts[1] offered by sellers. In many lines of business those who sell merchandise offer a substantial cash discount for payment within a specified time period. When taken regularly, cash discounts may provide a concern's total profit for the year. It becomes economical under these conditions to borrow from a bank in order to secure funds to pay bills within the cash-discount period. The offering of cash discounts by sellers enables them to secure quick possession of their money for use in their own business and to reduce credit risks.

A further reason for paying cash is that by so doing the buyer frees himself from the control of the supplying firm. When a

[1] Various types of discounts are discussed in Chap. XV.

business concern is indebted to other firms, the possibility of indirect control over its managerial policies may at times become a serious handicap to the successful and impersonal direction of its affairs.

Installment Credit.[1]—One type of consumer credit, installment credit, deserves special mention. Originally it was used in the sale of such major consumer purchases as furniture and agricultural implements. It was later extended to automobiles, refrigerators, radios, and similar merchandise. At the present time installment terms are being offered to purchasers of clothing. It has been estimated that over half of all the automobiles sold in this country are purchased on installment terms and that the total installment business in 1937 amounted to 14 per cent of all retail sales.

The growth of the installment business appears to bear a direct relation to the distribution of income among consumers in this country. Consumer articles at high unit prices have been sold first to those in the upper income classes. Consumers in these income groups have been able to pay for their purchases directly in cash. As these markets became saturated the possibility of maintaining mass production was limited unless new markets could be opened. There were millions of consumers anxious to purchase automobiles, refrigerators, radios, and furniture. Their lower incomes prevented them from paying cash. The granting of installment credit, which enabled consumers to make a series of small payments extending over a period of as long as 2 or 3 years, opened to manufacturers markets far exceeding in size those in which they formerly had sold. To the extent, therefore, that installment credit has brought many types of merchandise within the reach of the mass of our population, it has been of genuine service in distribution.

Dangers of Installment Selling.—It should be noted, however, that the use of installment credit is not without some dangers.[2] Men experienced in its administration have pointed out that the

[1] Seligman, E. R. A., "The Economics of Installment Selling," Vol. 1, 2, Harper & Brothers, 1927.

Griffin, B. H., and Greene, H. C., "Installment Credits and Collections and the Installment Market," Prentice-Hall, Inc., 1936.

[2] For some of the dangers of installment selling from the viewpoint of the purchaser see Look Before You Sign, *Consumers Guide*, February 27, 1939, p. 10.

sound handling of the installment-credit technique requires the payment by the customer of a substantial proportion of the total price as the first down payment and the completion of all installments well within the total use period of the merchandise purchased. It also requires that merchandise sold on installment terms have a high repossession value. Under these criteria it would be called dangerous to sell merchandise with a small down payment or with no down payment, to permit the installment payments to extend for a period as long as or longer than the article could be used by the customer, or to sell on the installment basis merchandise, such as clothing, which has little or no value when repossessed. And yet, under the stress of competition, installment terms have become more and more liberal. The amount of the down payment has been reduced. In many cases no down payment is required. The length of the purchase period has been extended. Merchandise with little repossession value has been offered on installment terms.

The dangers facing a continuance of this procedure are apparent. Some efforts have been made to regulate the granting of installment credit on a sounder basis. Competitive pressure and the struggle for sales during periods of depressed business have made such retrenchment efforts difficult. In many cases the leaders in offering overliberal purchase terms have been retail stores operated with little knowledge of the true costs of installment selling. Many of these stores have had a brief business life, but they have been continually replaced by others operated by men with as little knowledge of the dangers and costs of installment selling. Extended too liberally and with too little regard for the adaptability of various types of merchandise to the installment selling technique, this type of consumer credit may become a difficult one to control.

The Cost of Credit.—The extension of credit is a business expense. In a number of cases, however, businessmen have been guilty of failing to recognize the extent of the expenses which are incurred by granting credit. Expenses are incurred not only for maintaining the necessary bookkeeping records. They are also incurred for such activities as investigating applications, making collections, and repossessing merchandise after failure to complete payments according to contract. They are incurred in handling and selling repossessed merchandise. They are incurred as

interest charges on unpaid balances. Like the cost of every other marketing function, the cost of extending credit is a legitimate business expense. The error lies in the failure to appraise it accurately, and in the failure to enter as a true cost losses on bad debts.

A better recognition of this fact seems to be gaining ground in distribution. We are witnessing the creation of a division between wholesale houses which grant credit and those which do not, between retail stores which grant credit or sell on the installment basis and those which do not. This distinction is made obvious by a price differential. The customer is offered a free choice: if he wants to receive credit, there is a price he must pay; if he wants to pay cash, there is another price he must pay. The recognition and acceptance of the place of credit and the cost of credit must be regarded as a favorable trend in distribution.

CHAPTER XIV

RISK

"The organized commodity exchanges are run by speculators, for speculators, and at the expense of producers and the public."

"Trading in future contracts does not minimize price fluctuations. I should prefer to say that it increases them."

"Without the aid of organized commodity exchanges, the risks which are inherent in marketing would be so great that prices would be forced up in an effort to compensate for uninsured and uninsurable risks."

Risk in Marketing.—The nature of risk is uncertainty. The country elevator operator purchases wheat from farmers in his own neighborhood. He pays them a price based on the latest available quotations of the Chicago cash price for wheat. He allows a margin sufficient to cover transportation and carrying costs and to yield him a profit. Some time may elapse, however, before he sells that wheat in Chicago. During that period the price may rise or the price may fall. If it should fall, his risk of loss would be very great. A flour mill purchases wheat to grind into flour. If the price of wheat remains unchanged during the manufacturing period, the flour can probably be sold at a profit. Before that flour is ready for the market, however, the price of wheat may have changed carrying with it the price of flour. Again there is a potential loss which depends upon the movement of price which may not always be accurately forecast. A retail store purchases men's topcoats. Unexpectedly, after the topcoats have been in the store only 2 weeks, the manufacturer's price of men's topcoats declines. Other stores buy topcoats at lower prices and offer them at retail prices which are below the prices at which the first store can offer its topcoats and still earn a profit. The store is forced to reduce the price of its topcoats and suffer a loss.

The nature of risk is uncertainty: uncertainty as to the future course of prices; uncertainty as to the future course of styles; uncertainty as to the future desires of consumers; uncertainty as to the occurrence of theft, loss from bad debts, business depres-

sions, crop failures, natural calamities, or governmental action. The nature of risk is uncertainty about future occurrences concerning which guesses or estimates may be made, but upon the accuracy of which it may be dangerous to rely.

Risk pervades every part of the business system. It may, under some conditions, be minimized. It may be shared. It may be protected against. Under certain conditions there may be no way of minimizing, sharing, or protecting against risk. Risk must, therefore, have a direct effect upon marketing costs. At what points in the marketing process does risk become important? How may it be guarded against or minimized or shared? At what point is there no defense against risk? To what extent are costs of marketing raised because of the existence of risk? To answer these questions, it is necessary to look a little further into the nature of risk, the forces which cause it to arise, and the ways and means by which it can be controlled.

The Classification of Risk.—Risks may be divided into two broad classifications, insurable risks and uninsurable risks. Into the class of insurable risks fall all those types of business uncertainties against which complete or partial protection may be found through some type of shifting, sharing, or elimination. At least partial protection against insurable risks may be secured in some cases through insurance, in others through the use of written contracts, in still other cases through hedging. Into this class of risks fall the risks of fire, theft, storm, etc. Into the classification of uninsurable risks fall all those business uncertainties which arise from mistakes in judgment and from the inability accurately to foresee the future. Here may be listed manufacturing too much or too little, attempting to sell in the wrong market, featuring poor styles, and similar business risks.

Uninsurable risks may be reduced by the amassing of a greater quantity of information about consumers, competitors, market conditions, supply conditions, and the experience and current conditions of the individual business firm itself. Such information must be regarded only as an aid to the formation of judgment. Its limitations indicate clearly the area within which some measure of protection may be found for the class of uninsurable risks. It is difficult indeed to visualize business operation without a large proportion of risks which can in no way be minimized, shared, or shifted. The more business can confine

its risks within the insurable classification, the more control will business management exercise over its affairs, and in the long run the lower will be the costs of marketing. This last effect must follow, inasmuch as the incidence of risk in marketing is not the least of the forces creating high costs of distribution.

A little further examination into the matter of risk in marketing may help to illuminate the reasons for its existence and the extent to which business can find protection against risk. There appears to be a direct relationship between the degree of risk incurred in any business situation and the time during which the condition which brought about the risk continues to exist. We can imagine a company buying raw materials in January, carrying on manufacturing operations in February, and selling the finished product in March. The company faces several major risks. There is the risk of price change between the time when raw materials are first purchased and the time when finished goods can be sold. A rise in the price of the finished goods will be very favorable for the company. A fall in the price of finished goods may be disastrous. If the product manufactured is one affected by style change, the risk connected with that change of style will be increased in direct proportion to the length of time during which the company is engaged in manufacturing and in holding in stock merchandise prior to sale. Those risks which arise from competitive business practice also will increase as the time interval becomes longer because there is more opportunity for competitors to change their tactics, to offer new merchandise, to change their prices, or to change their marketing policies.

The longer the time interval between the purchase of raw materials and the sale of finished goods, the more opportunity there is for changes in consumer buying habits which may be reflected in the demand for different brands of merchandise, in consumer attitudes toward prices, and in consumer preferences for different styles. It should also be noticed that the risks which arise from changes in general business conditions increase in direct proportion to the time interval between purchase and sale. A period of 1 month elapsing between the purchase of raw materials and the sale of finished goods may be so short that the risk of a major change in the business cycle is not very great. A period of 4 or 5 months, however, is sufficient to encompass

a direct reversal of the trend of general business with all the risks which follow from a sudden shift in consumer demand created by the swing to a different phase of the business cycle.

If we imagine in the same industry another company which has a longer productive and marketing cycle, we can easily see why the risks incurred by the second company are greater than those incurred by the first. The second company may purchase raw material in January, but may be engaged in production during February, March, and April and may not be ready to sell its merchandise until May or June. This company incurs all the risks faced by the first company, but the risks are greater in the longer time interval. The risks arising from changes in prices, styles, general business conditions, and the opportunity for the development of new competitive practices increase in direct relation to the time interval.

There is another method of classifying risks as place risks and time risks. Place risk arises from the fact that prices for the same commodity may not be similar at different points where that commodity is offered for sale. The increase in the number of well-organized markets publishing information about prices and commodities offered for sale serves to minimize place risks. Most commodities offered for sale in this country, however, are still disposed of in semiorganized or unorganized markets. Where such conditions exist place risks rising from unjustifiable price differentials between various markets may become an important part of the uncertainties which surround a business venture. Time risk arises chiefly from seasonal differentiations in producing, selling, and consuming. Increased market knowledge may offer partial protection against this type of risk.

Handling Risks.—If these are the risks of marketing, what methods are available for minimizing, shifting, sharing, or insuring against these risks? As might be expected, a number of devices and policies are available to the marketing executive. Among these may be included more effective sales efforts, an increase in market information, business cooperation, the use of various types of insurance, and the use of the written contract. Under the last classification may be listed the device of hedging.

The direction of executive effort toward making selling more effective may in a number of cases be an important means of minimizing common marketing risks of the uninsurable

type. It may help to maintain sales at a regular pace throughout the year and serve as a bulwark against the normal effects of the business cycle. It may protect a company against the ravages of competition, which may result in shifting consumer demand away from a company's products. It may develop among consumers a feeling of good will toward, and confidence in, the company, which will result in continued customer patronage. It may do all this at the lowest possible cost consistent with effective distribution. The risks which are minimized by such business activity may be an important part of all the dangers to be encountered in distribution. There remain, of course, many other risks which must be handled differently.

To some extent risk may be lessened by the removal of certain parts of distribution from the realm of fierce competition. The forces of competition are such that a monopoly avoids a number of risks which must be met by a company facing severe competition. As a result agreements have been made among competitors covering prices, services, and terms. These agreements may be worked out through trade associations. A business may go one step further and secure protection against such risk by merger and integration.

The wider dissemination of market news; of information about prices, supply, and demand at various points; or forecasts of future supplies and supply and demand conditions in other countries all assist in minimizing business risks. Many of the risks of distribution arise because of lack of knowledge. To the extent that marketing executives know their markets and know the conditions which overhang those markets, they lessen the danger of loss arising from uncertainty. In recent years the number of sources supplying market news and the accuracy of that news have increased many times. There still remains, however, a large area of marketing concerning which little is known. There still remain many uncertainties which arise from inability to interpret what market news is available. At the present time, however, marketing executives seem thoroughly aware of the importance of gathering as much information as possible about the conditions under which they must do business. Skill in interpretation of statistics is increasing, and it may be safe to state that risks of this type will be reduced in the future. Except in the static state, however, such risks apparently cannot

be avoided entirely. They will continue to form part of the conditions under which business must operate.

Bearing the Residual Risk.—Despite the devices for minimizing the risks of marketing which have been described in the preceding pages, much uncertainty continues to exist. The problem then becomes one of determining who shall bear the risk. The residual risk, those risks which cannot be avoided by skillful sales efforts, by combination, or by greater market information may be shifted by means of contract or divided by means of insurance.

There is risk incurred by business as a result of changes in the conditions under which business operates during a short time period. Prices may move upward or downward. Sources of supply may fail to make deliveries. Purchasers may change their minds. Such risks may be shifted or avoided by the use of written contracts which specify on what terms sales will be made; when, where, and at what prices supplies will be delivered; and when and on what terms purchasers will accept deliveries. The risk is then shifted from the easy possibility of change of mind to the less frequent occurrence of failure to carry out a contract. As a last recourse the writer of the contract may turn to the courts.

Another type of contract may be listed under the general heading of insurance. Through the use of insurance against many types of uncertainties, the cost of bearing the risk may be divided among a great many potential risk bearers. The cost to any single concern is a very small part of the loss it might suffer if it attempted to bear such risks alone.

It should be pointed out that not all businessmen seek to minimize risks. Occasionally, for various reasons, businessmen may decide to accept the burden of risk themselves. In such circumstances, of course, they balance the possibility of larger profits resulting from a favorable swing of prices or the nonoccurrence of fire or theft against the possibility of such losses as may arise from an unfavorable swing of prices or the occurrence of fire or theft. They are gambling on larger profits with the added danger of larger losses. More commonly, however, unusual attempts are made to shift or minimize risk, or in other ways to guarantee a concern against the burden of all insurable risks.

A clear differentiation should be made between trade risks and speculative risks. Trade risks are those naturally and inevitably attached to the operation of a business. Speculative risks are those which may be assumed by a businessman as a venturesome undertaking; they are not normally a part of his business. The retailer must buy in advance of consumer purchase in order to have merchandise to show his customers. Purchasing in excess of his customary requirements, when he thinks he foresees a long-continued rise in prices, is not part of his necessary business operations. When he does buy in this way, attempting to profit by the accurate forecast of future price movements, he is assuming a speculative risk.

The importance of middlemen as agents assuming part of the burden of risk in marketing should not be overlooked. Middlemen who assume title to merchandise buy from producers before reselling to later purchasers. During the period of ownership, together with title to merchandise, they assume the risks of ownership. Without the intervention of middlemen these risks must inevitably be supported by either the original producers or the ultimate purchasers. Risk in business follows the ownership of merchandise. Ownership and risk are inescapably tied together.

The Commodity Exchanges.—The agencies which make possible the insuring device known as the hedge are the organized commodity exchanges[1] of which the Chicago Board of Trade is an outstanding example.[2] Exchanges provide facilities for trading under established rules of procedure in predetermined standardized grades of specialized basic commodities.[3] Trading on the exchanges is limited to members. The members may buy and sell for their own account, or they may serve as brokers or commission agents acting for outside interests. The grades of the commodities bought and sold on the organized exchanges are established by the rules of the exchanges and are supervised and governed by the exchanges. As a result of the establishment of these basic rules and grades most of the organized exchanges

[1] Baer, J. B., and G. P. Woodruff, "Commodity Exchanges," Harper & Brothers, 1929.

[2] Learned, E. P., "Problems in Marketing," pp. 264–273, McGraw-Hill Book Company, Inc., 1936.

[3] For an interesting discussion of the trading process see R. H. Moulton, "Trading in Grain," Chicago Board of Trade, 1938.

offer two separate trading markets to their members and to outsiders acting through their members. One of these basic markets is the cash market, and the other is the future market. If we use as an example the wheat markets, we can note the following facts about their practices. In the cash market for wheat, buying and selling take place for the actual sale and delivery of wheat.[1] An order may be placed, for example, through a member of the Chicago Board of Trade to purchase 10,000 bu. of wheat of a specified grade. That order will be placed in the cash market and actual wheat will be delivered to the purchaser. All contracts are written in terms of the actual delivery of wheat, and a purchaser in the cash market expects that actual wheat will be delivered to him in the amount and grade specified in the contract.

This differs from trade in the future market where future trading, *i.e.*, buying and selling, takes place not in terms of actual wheat but in terms of contracts calling for the delivery of a specified grade of wheat at a specified future date.[2] A purchaser may place an order with a member of the Chicago Board of Trade in July calling for the delivery of 10,000 bu. of wheat of a specified grade in December. He buys a contract calling for such delivery. This is commonly referred to as buying a December future. It is entirely possible that the purchaser expects to receive 10,000 bu. of wheat in contract grade in December. In fact, by the strict terms of the contract, he must expect to receive that wheat and must be prepared to accept it. In actual practice, however, little wheat is ever delivered on the basis of future contracts, and few purchasers of future contracts ever expect to take delivery of wheat. They buy a future contract with the expectation of selling the contract before the delivery date. They may have no interest whatsoever in receiving actual wheat. They buy a December future with the expectation of selling a December future before the end of that month. Trading in future contracts is carried on by businessmen usually not for the acquisition

[1] This discussion centers around the trading in wheat. The Chicago Board of Trade also deals in the other grains, cotton, and provisions. The New York Produce Exchange deals in a wide variety of produce. Others, such as the New Orleans Cotton Exchange and the New York Cocoa Exchange, specialize in certain commodities.

[2] Hoffman, G. W., "Future Trading upon Organized Commodity Markets in the United States," University of Pennsylvania Press, 1932.

of wheat but for a price protection device known as the "hedge." The same statement applies to future trading in every other commodity for which such markets exist.

The service of the commodity exchange may be briefly summarized under the following headings: the provision of a place where buying and selling may be carried on; the supervision of buying and selling by members of the exchange and the administration of such rules as may be set up by the exchange for the governance of its members and their activities; the establishment and maintenance of recognized grades and standards for the commodity handled; the provision of adequate facilities for the collection and dissemination of market news relating to quantities, qualities, and prices; and the provision of regulations governing the establishment of the activities of a future market.

Hedging.—The basis for hedging is the existence of two markets, one a cash and one a future market, price movements in which are tied together so that advances and declines in prices occur practically simultaneously and to the same magnitude in both markets. These conditions may be generally said to prevail on all the organized commodity exchanges which provide both cash and future markets. Under normal conditions prices in future markets are higher than prices in cash markets. Under normal conditions advances in prices in the two markets occur at about the same time and to the same degree.[1] Under normal conditions declines in prices in the two markets occur at about the same time and to the same degree. Unless these conditions prevail, the measure of protection against the risks arising from unforeseen price movements, which is offered by the hedge, will not be fully available.

To take one example of this situation,[2] let us suppose that early in September the cash price for a specified grade of wheat on the Chicago Board of Trade is 79 cts. per bushel. This means that the price of a bushel of wheat of the specified grade delivered at once is 79 cts. On the same day the future price for the same grade of wheat deliverable on contract in

[1] Stevens, W. H. S., The Relation of the Cash-future Spread to Hedging Transactions, *The Journal of Business*, January, 1929, p. 28.

[2] Mehl, J. M., Hedging in Grain Futures, U.S. Department of Agriculture, 1931.

December, 3 months ahead, may be 85 cts. per bushel. If, 1 week later in September, the cash price advances to 85 cts. per bushel, under normal conditions the future price for December wheat will also advance by the same amount to 91 cts. per bushel. Unless this relation is maintained, hedging cannot be carried on as a perfect guarantee against the loss from price fluctuations.

The margin existing at any date between the cash price and the future price is known as the "spread." Under normal conditions the spread between the cash price and the future price is equal to the cost of storing and insuring 1 bu. of wheat from the date of the cash price to the date of the future contract. In the example we have used above, the 6-ct. spread existing in September between the specified cash price and the December future price should be equal to the cost of storing and insuring 1 bu. of wheat from September to December. Obviously the spread between cash and future price should narrow as the date of the future contracts draws nearer; *i.e.*, in the example used above, if the spread in September is 6 cts., it should grow progressively smaller during the fall season until at the end of December the cash price should be exactly equal to the December future price for wheat of the same grade, provided that the spread is always equal to the cost of carrying wheat to the date of the future contract. The fact that the spread narrows as the date of the future contract approaches does not in any way affect the success of the hedging operation. If we defer temporarily the discussion of those conditions which cause the spread to vary from its normal range, we may find some simple illustrations of the practice of hedging.

The essential purpose of hedging is to secure protection against random fluctuations of prices. A country elevator operator who engages in the hedging of wheat does so because he wants to protect his normal trade profit earned from the operation of his wheat elevator.[1] He does not want to see that profit endangered by an adverse movement in the price of wheat while he is holding wheat. On any day a country elevator operator buying wheat from farmers offers to farmers a price based directly on the cash price for wheat of similar grade in the nearest central wheat market. If the cash price for wheat in Chicago today is 79 cts.

[1] Malott, D. W., "Problems in Agricultural Marketing," pp. 127–130, McGraw-Hill Book Company, Inc., 1938.

He has still suffered a net loss of 6 cts. per bushel on the November transaction which exactly balances his gain on the September transaction.

The operation of hedging, therefore, has secured to him his normal trade profit accruing as a result of the operation of his elevator. If he had not hedged and if the price of wheat had advanced between September and November, he obviously would have secured in addition to his normal trade profit an added gain of speculative character of 6 cts. per bushel, inasmuch as he bought wheat in September at a price based upon the Chicago price of 79 cts. per bushel and sold his wheat in November at 85 cts. per bushel. On the other hand, if the price in November had declined to 73 cts. per bushel, he would have suffered a net loss of 6 cts. per bushel which would have been sufficient to wipe out his profit and bring him a serious loss. He hedged because he could not foresee the future movements of prices, because he was unwilling to bear the risk of a decline in price or to balance that risk against the possibility of an advance in price.

The same type of hedging operation may be carried on by a terminal elevator operator desiring to protect himself against unforeseen price movements while wheat is in his possession; by a miller desiring to protect himself against adverse price movements; and by businessmen engaged in handling any of the other commodities which are bought and sold on organized exchanges providing both cash and future markets. The purpose of hedging is the protection of the normal trade profit. The method of the hedge is a matching purchase and sale in two markets, the price movements in which proceed together in the same direction and to the same extent. A purchase in the cash market is immediately matched by a sale in the future market. This action constitutes the first half of the hedge. The hedge is completed by a sale in the cash market balanced by a purchase in the future market. The purchase and the sale in the cash market clear the businessman of the ownership of cash wheat. The sale and then the purchase in the future market clear him of the liability to deliver wheat at the date specified in the future contract. This is an example of a hedge under perfect conditions. A number of qualifications should be noticed.

The fact that the spread between the cash price and the future price tends to narrow as the date of the future contract draws near has already been pointed out. This does not in any way affect the validity of the hedging operation. To use the example offered above once more, let us suppose that the elevator operator in September buys wheat from farmers at a price based directly on the cash price of 79 cts. per bushel. On the same day he sells a December future contract at 85 cts. per bushel representing a net gain of 6 cts. per bushel. In November, when he sells his cash wheat, under normal conditions the spread will not be 6 cts. per bushel. It will be less because the date of the future contract is nearer. In November the spread may be only 3 cts. per bushel. If this occurs, then his November transaction will look like this:

(*a*) November		
	Sell 5,000 bu. cash wheat (specified grade)	at 73 cts. per bu.
(*b*)	Buy 5,000 bu. December future	at 76 cts. per bu.
	Net loss	3 cts. per bu.

On this transaction the operator suffers a net loss of 3 cts. per bushel. If this is balanced with his previous gain of 6 cts. on the September transaction, he will realize a net gain of 3 cts. per bushel. The decline in the spread, however, should be roughly equal to the cost of storing the wheat from the day the first half of the hedge was entered into to the day the hedge was completed. Under normal conditions it costs the elevator operator approximately 3 cts. per bushel to store and insure wheat from September to November. As a result of this cost his hedge will still be a perfect protection. On the hedging operation alone he has gained 3 cts. per bushel. It has cost him 3 cts. per bushel, however, to store wheat from September to November. The 3 cts. per bushel storage charge balances the 3 cts. per bushel gain on the hedge so that he still has a perfect protection for his business profit.

Hedging Not Always a Perfect Protection.—Hedging, unfortunately, does not always offer perfect protection.[1] This failure arises from the fact that movements of prices in the cash market and in the future market are not always parallel. From time

[1] Hoffman, G. W., "Hedging by Dealing in Grain Futures," Chap. IV, Thesis at the University of Pennsylvania, 1925.

to time conditions may arise which cause prices in the future market to diverge from prices in the cash market. Occasionally the future price may even be found below the cash price. The divergence of future price from cash price diminishes the utility of the hedge and destroys the value of hedging as a perfect protection against price fluctuations. To use the same example we have offered before, we may suppose that, when the elevator operator is prepared to sell his wheat in November, conditions are such that the hedge would not be perfect. His November transaction may yield the following results:

(*a*) November	
Sell 5,000 bu. cash wheat (specified grade)	at 73 cts. per bu.
(*b*) Buy 5,000 bu. December future	at 78 cts. per bu.
Net loss	5 cts. per bu.

The net result of this transaction is a loss of 5 cts. per bushel. If this is balanced against the gain of 6 cts. per bushel on the first half of the hedging transaction in September, the elevator operator will realize a net gain of only 1 ct. a bushel against which he must balance his cost of 3 cts. per bushel for storing and insuring the wheat from September to November. As a result of this failure of the spread to remain constant, the elevator operator does not secure a perfect hedge. He suffers a small loss from his hedging transaction.

It should be noticed, however, that the loss is not so great as it might have been had he failed to hedge and had the price declined from 79 cts. per bushel to 73 cts. per bushel. In this situation the hedge has not been a perfect protection against price fluctuations. It has offered a measure of protection, however, which has minimized the potential loss facing the elevator operator. In the situation described here, the spread has widened between the date when the hedge was begun and the date when the hedge was completed. If the spread had narrowed during that period more than enough to compensate for the cost of storing wheat, the operation would have looked like this:

(*a*) November	
Sell 5,000 bu. cash wheat (specified grade)	at 73 cts. per bu.
(*b*) Buy 5,000 bu. December future	at 74 cts. per bu.
Net loss	1 ct. per bu.

On this transaction the elevator operator suffers a net loss of 1 ct. per bushel. Balancing this loss against his gain of 6 cts. per bushel on the September part of the hedge, he realizes a net gain of 5 cts. per bushel. If he subtracts from this the cost of carrying wheat from September to November, 3 cts. a bushel, he will realize a net gain on the whole transaction of 2 cts. per bushel. If the spread narrows, therefore, more than enough to compensate for the cost of storing wheat, the hedger may secure an extra gain. If the spread widens, he will suffer a loss.

Hedging rarely provides perfect protection of business profits. The spread between cash price and future price is rarely exactly equal to the cost of storing wheat. Hedging does, however, provide such a measure of protection that it seems desirable for businessmen to hedge and get at least partial protection rather than avoid the hedge and run the risk of suffering even greater losses.

Hedging does not afford perfect protection when price movements in the cash and future markets are not exactly parallel. These price movements are not parallel when special conditions affect one market without affecting the other. In certain periods, for example, there may be available an ample supply of cash wheat. At the same time the forecast for future crops may be very pessimistic. In the future market, therefore, the supply will appear to be inadequate. The future price may be forced upward at a time when the ample supply in the cash market does not encourage a corresponding rise of the cash price. Under these conditions the spread between cash price and future price may widen. At other times the opposite situation may be encountered. There may be fine prospects for an ample harvest in the future, a condition which will operate to depress future prices. At the same time the supply in cash wheat may be insufficient to satisfy the existing demand. This situation will act to force upward the cash price, and as a result the spread between cash price and future price may narrow. The action of such adverse forces upon cash price and future price have occasionally been so severe as to raise the cash price above the future price for short periods of time. Such a situation, however, must be viewed as one of relatively infrequent occurrence.

There are other reasons for imperfect security in hedging. The hedger may not be able to secure a perfect adjustment

between the quantities bought and sold in cash and future markets. The hedger must pay brokerage charges on his purchases and sales. Changes in price may occur before he is able to complete his hedging operation. Here, too, however, the degree of imperfection in the hedge is relatively slight.

Risk and Speculation.—A discussion of hedging cannot be complete without mention of the controversial problem of speculation on the commodity exchanges. A heated debate has been waged about this point for a number of years, and governmental action has been taken in the attempt to curb what have been called "the evils of speculation." It should be said that, so far as present evidence indicates, there is no clear proof that speculation on commodity exchanges has been an unmitigated blessing or evil. To permit hedging to be carried on at all requires that the commodity markets be "continuous" markets. It requires that there be a constant supply of buyers and sellers present and active in the markets at all times. It requires that, whenever a businessman wishes to hedge his operations and offers to buy and sell future contracts, there will be available others in the market who will deal with him promptly. Only in this way can hedging be carried on and only in this way can there be a prompt acceptance of all orders so as to minimize the disastrous effect of price fluctuations.

When hedging operations are carried on, risks are not made to vanish. The elevator operator who hedges transfers the risk of price fluctuations to others. This action appears to indicate the need for the presence of specialists in assuming risks, and under many conditions these specialists or market traders may be called speculators since they earn their profits from the favorable forecasting of future price movements.[1] They buy and sell without the intention of taking possession of the actual

[1] J. H. Frederick, "Industrial Marketing," p. 12, Prentice-Hall, Inc., 1934, says, "The shifting of the risk of price changes to speculators, through the purchase and sale of contracts for future delivery, costs the party who so seeks to shift his risk practically nothing outside of the commissions involved in buying and selling the future contracts. This is so because the risk is assumed by speculators, who carry it for nothing, their only hope of profit lying in getting it out of one another. This, incidentally, is the reason why most of them ultimately lose. In the meantime, however, they have performed a very valuable function from the standpoint of marketing certain agricultural products, through their organized speculative activities."

commodities. How necessary they are to the successful marketing of basic farm crops may in part be inferred from the conditions which might overshadow the markets were they not active in them. Price movements might be much more abrupt and price changes of greater magnitude. To the extent that they minimize price fluctuations and provide a continuous market, they are of undoubted benefit in distribution. The attack upon them, however, is not directed against this aspect of their functions. Rather it is based on the charge that they frequently act to cause prices to rise or decline when the normal supply and demand conditions do not support such price changes.[1] Misleading information may be circulated on the strength of which prices are driven up or forced down for the sole purpose of securing a speculative profit for market manipulators. Many farmers have charged that the leading commodity markets have operated over a period of years to depress prices below normal levels.

The most searching investigation launched into the question of speculative activities on commodity exchanges emerged with an inconclusive statement. Evidence could not be produced to support the proposition that speculation benefited distribution; neither could evidence be brought forth to support the proposition that speculation hindered the distribution of the basic farm commodities. Perhaps the only safe conclusion that can be reached at the present time is that certain aspects of speculation are of undoubted harm; that uncurbed speculation may in particular instances do great damage and may for short periods bring about unhealthy and abnormal price movements. Yet it is difficult to imagine the distribution of the basic crops without a measure of speculative activity on the organized exchanges. To this extent speculation may properly be viewed as an integral part of the distributive process for all products bought and sold on organized commodity exchanges.

One more comment is necessary. It has already been pointed out that hedging does not at all times offer a perfect protection against unforeseen price fluctuations. Not all businessmen and not all agencies engaged in the marketing of the basic crops for which hedging is possible make use of the hedge. Hedging is the common practice wherever organized commodity exchanges

[1] Cutten, A. W., The Story of a Speculator, *The Saturday Evening Post*, Nov. 19, 1932.

make it possible. It is not, however, the universal practice. There are many engaged in marketing who, from time to time and particularly when they think the situation is favorable, attempt to secure an additional speculative profit resulting from a favorable movement in prices. Some studies indeed have reached the conclusion that, for certain types of business over a long period of years, hedging offers only slight advantage.[1] To the extent that it does protect a business profit, as distinguished from a speculative profit, it may be regarded as an aid to distribution and as one of the many devices utilized by business in dealing with economic risks.

[1] McNair, M. P., The Feasibility of Protective Hedging for a Cotton Gray Goods Manufacturer, *Harvard Business Review*, March, 1929, p. 288.

PART IV

MARKETING PROBLEMS

In Part IV you will find a discussion of a number of basic marketing problems. Remember that they are not framed in a vacuum. They arise in connection with every marketing activity; they are closely bound up with every important marketing function. Try to examine them not as problems in the abstract, but as *marketing* problems which can be solved only through an understanding of basic marketing procedures.

CHAPTER XV

PRICE

"It is impossible to evaluate the efficiency of marketing except in terms of quality and price. The welfare of the nation is a function of its real income which must be measured by the goods which money can buy."

"To think of price as being determined by competition is to misinterpret the simple facts of everyday experience."

The Influence of Prices.—Prices lie at the heart of economic life. "Today prices are pivots upon which the whole system of business moves."[1] When the average consumer enters a store to make a purchase, her major interest is in the price of what she wants to buy. Consumers are not alone in their interest in prices. Retailers, wholesalers, and manufacturers think in terms of prices and must inevitably do so since they are operating their businesses with a view toward obtaining results measurable as profits or losses. To a very great extent profits and losses are the result of the interaction of a complex series of prices. Prices affect the determination of marketing channels. In so far as they enter into costs, they determine where goods may be sold. They affect the competitive situation in every market. They limit markets. It may truly be said that there is not one aspect of distribution which escapes the influence of price.

Despite the importance of prices, the great attention which has been devoted to them, and the prominent part they play in the daily lives of consumers, there still exists much misunderstanding with regard to the nature of prices. Particularly is there misunderstanding about how prices are determined.[2] This misunderstanding may be due in part to a confusion of terms between "normal price" and "market price." There

[1] Hamilton, W., *et al.*, "Price and Price Policies," p. 25, McGraw-Hill Book Company, Inc., 1938.

[2] Nourse, E. G., and H. B. Drury, "Industrial Price Policies and Economic Progress," Chap. XI, Brookings Institution, 1938.

may be further confusion arising from varying attitudes toward the conditions under which prices are formed. From one point of view the formation of prices is regarded as an action resulting from perfect competition. From another point of view the formation of prices is regarded as an action arising under conditions of monopoly. More recently the formation of prices has been regarded as an action arising under conditions of "imperfect competition" or "competitive monopoly."

The common phenomena of prices are so complex that it is not surprising that the confusion about prices has not been clarified. It is impossible to think of prices without at the same time considering both the quality and the quantity of the merchandise. It is impossible to think clearly about prices without at the same time considering questions of services offered with merchandise. It is impossible to think clearly about prices without considering competitive conditions under which prices are formed. It is impossible to think clearly about prices without considering substitute products. Many of these factors are of a kind which may be called intangible. They do not lend themselves to measurement in physical units. As a result practically all thinking about prices must involve an element of uncertainty which effectually limits the analysis and prevents the study of prices from becoming an exact science.

Market Price and Normal Price.—One difficulty must be attacked at the outset. The concept of normal price is clearly a concept developed by economic theory. It refers to that price which in the long run must be secured to maintain economic activity, that price which in the long run covers the cost of production and marketing. This is a valuable concept for economists. It should be clearly stated, however, that in the practice of actual business the concept of normal price is seldom encountered. Businessmen operate under conditions of market price, which differs from normal price. Normal price is based on the long-run outlook. Market price is the current price, the actual price secured today. Businessmen operate under conditions of current prices and with the aid of comparatively short-term forecasts of future prices. It is perfectly conceivable that at any time market price may be substantially over or substantially under the costs of production. At any particular time market price may have no relation to the costs of production.

Consideration of production and distribution costs may be helpful in analyzing market price; it should not be regarded as the sole factor determining market price.

Monopoly Price and Competitive Price.—A further difficulty arises in distinguishing between the various aspects of the conditions under which prices are formed. Early economic theory clearly defined two separate and distinct sets of circumstances under which prices are formed: the situation of perfect competition; the situation of perfect monopoly. Under conditions of perfect competition there were present in the market a large number of sellers and a large number of buyers each dealing in the same commodity and the activities of each being so insignificant as compared with the total quantity handled that no single buyer or seller through his actions could possibly have any effect upon price. Such a situation may be compared with the relation between the individual Dakota wheat farmer and the price of wheat on the Chicago Board of Trade. The decision of the wheat farmer to refrain from raising wheat in the effort to decrease the supply offered and so force up the price in Chicago would, of course, have no effect upon the price. Under conditions of perfect competition, price was viewed as the outcome of the interaction of supply and demand which could be equalized at only one price. If, at a given price, the supply offered was in excess of the amount demanded, the price would tend to fall toward a new equalization point, and if the amount demanded was in excess of the amount supplied, the price would tend to rise toward a new equalization point. The price might never reach a point of perfect equilibrium as to both supply and demand, but it would continue to move above or below and always tend toward the equilibrium point.

Under conditions of perfect monopoly, decisions with regard to the making of price were held to be framed by a monopolist considering his market. His aim was to secure for himself the maximum income. He knew that at a high price he would sell a certain number of units. At a lower price he would sell more units. At a still lower price he would sell even more units. His task was to consider the hypothetical demand curve and select that price which would maximize his returns, *i.e.*, give him the greatest profit.

Price, the Result of Imperfect Competition.—More recently the tendency for economic thought has been to consider price as the result of conditions of imperfect competition or competitive monopoly.[1] This outlook on the economic world claims rarely to find conditions of perfect competition;[2] as seldom are found conditions of perfect monopoly. Markets which were formerly thought to be characterized by perfect competition have been shown upon analysis to be characterized by competition among a series of semimonopolies. It has been pointed out, for instance, that competitive conditions among the leading four cigarette manufacturers are not examples of perfect competition because, as far as consumers are concerned, one brand is not freely interchangeable for another brand. There is a degree of brand preference built up on the basis of consumer taste and strengthened by large-scale advertising which places the manufacturer of each brand in a position which vaguely resembles that occupied by a monopolist. It may be true that the sales of any one of the leading brands would experience a drastic decline if its price should be advanced by as little as ½ ct. a package. It is also true that when all four brands are sold at the same price consumer preferences are strongly established and each manufacturer has a sure control of his market which clearly differentiates his position from that of the individual Dakota wheat farmer. On the other hand, conditions of perfect monopoly may be said rarely to exist, inasmuch as there is hardly a monopolist who can fix his price freely without considering the price of potential substitutes for his product. The Aluminum Company of America, occupying a dominant position in its industry, cannot price its products with a complete disregard for possible substitutes for aluminum. The monopolist is not operating solely

[1] Two basic texts dealing with this topic are Edward H. Chamberlin, "The Theory of Monopolistic Competition," Harvard University Press, 1933, and Arthur Robert Burns, "The Decline of Competition," McGraw-Hill Book Company, Inc., 1936.

[2] Bader, L., Recent Price Legislation and Economic Theory, *The Journal of Marketing*, October, 1938, p. 172. "The analysis here presented would suggest that the price legislation with which it deals tends to make business competition more imperfect than it was and if the acts are successful, the most important field where semblance of perfect competition prevailed will disappear."

with regard to a hypothetical demand curve at various points along which he can dispose of different amounts of his merchandise. He must at all times bear in mind consumer preference for his merchandise and the price scale of substitute products.

Further situations of competitive monopoly exist in retailing. Many retail stores are somewhat removed by reason of their location from direct competition with other stores selling similar merchandise. This may be true particularly if taken in conjunction with established consumer buying habits. One example of this type of situation may be found in the consumer market served by a small grocery store. If there are no competing grocery stores within an area of several blocks, the store may have a semimonopoly position. Consumers are in the habit of buying groceries in the most convenient retail outlet. They are usually disinclined to travel more than four or five blocks to make routine day-to-day purchases. Unless the prices or the merchandise or the services of the grocery store in question are far out of line, consumers living in the neighborhood will tend to concentrate their purchases at the store. It may be possible for the grocer to secure somewhat higher prices for many types of merchandise without alienating much of his trade. Such a situation is certainly not one of perfect competition, yet it exists throughout a large part of retail trade.

Another element contributing to the creation of semimonopolistic conditions in retailing is the general lack of knowledge on the part of consumers of competitive prices and services in various stores in the community. Observers have noted that it is quite possible for several stores in one community to offer the same merchandise at different prices and for all stores to receive a fair share of the community's business. This condition is made possible solely by one or both of two factors: consumers' lack of knowledge of the price situation, or consumers' disinclination to make the extra effort required to purchase in a more distant store. Variations in the types and qualities of services offered in different retail stores may also set up conditions of semimonopoly. A consumer may prefer to purchase groceries in one store, not because that store is more conveniently located or because it offers better merchandise or because its prices are more attractive, but simply because she likes the manager or one of the clerks and enjoys having him wait on her.

Similar conditions of semimonopoly may be found to exist throughout almost every phase of distribution, although the examples in wholesaling are less striking than those found in the field of retailing. Wherever such conditions exist, however, perfect competition is absent, and an analysis of the forces which shape prices which does not refer to the semimonopolistic background must be a misleading analysis.

Price in Large-scale Industries.—A different type of situation is frequently encountered in large-scale industry.[1] There are a number of industries in this country, of which the steel industry may be taken as an outstanding example, which are made up of a comparatively small number of large companies. In determining price policies, the executives of each of these companies do not think in terms of perfect competition. They are unable to do so because each company is so large that the decisions of its executives have a direct effect upon the general demand for the products produced by the industry. The situation is not similar to that faced by the individual wheat raiser considering the effect of his actions upon the price of wheat. The decision of an individual steel concern[2] to raise or lower its price for steel products has a direct effect upon the demand for steel, upon its own sales, and upon the price policies of competing steel companies. The decision of the Dakota wheat farmer to withhold his wheat from the market will be ineffectual in raising the price of wheat. The decision of one of the large steel companies to refuse to sell steel products at the prevailing price may be very effective in forcing up the price of steel products because that company's share of the total supply is large. By refusing to sell, it withholds from the market a large part of the supply, an action which, under normal supply and demand conditions, will force the price upward.

The same conditions apply with striking force to the decision of any of the large steel companies to lower prices. Market news in such an industry is so widely publicized that price-cutting activities by any one company must attract to it a major share of the total business and must force the other companies to meet

[1] Nourse and Drury, *op. cit.*, Chaps. VIII, IX.
Burns, *op. cit.*, Chap. III, pp. 204–225.

[2] The United States Steel Corporation, more often than any other corporation, is given as an example of such price leadership.

the price cut. As a direct result of these conditions the executives of companies in such industries cannot think of their own price policies without considering the repercussions on the price policies of competing concerns. In such industries the normal competitive condition of price cutting may be wholly absent without the slightest degree of collusion in maintaining prices. This condition may exist solely because the executives of one company know that, if they lower their price schedules for the products which they sell, competing companies will meet the price cuts immediately. The total demand for the products of the industry may not be increased. The single result may be that all companies are selling at lower prices. Under such conditions price cutting may be unknown or price policies may be shaped on a follow-the-leader policy based upon the action of the largest or most powerful concern in the industry.

Against this general background which reveals the existence of perfect competition or perfect monopoly in a very small part of the field of marketing, we must view the development of day-to-day prices. Under these conditions price is not merely an expression of equivalence for supply and demand. Market price may be the result only of a series of estimates directed toward maximizing the return to each seller. It may be subject to a great many influences both within and without the individual business concern. It may for considerable periods of time bear little relation to existing supply and demand conditions. One example of this situation may be found in the almost universal 5-ct. price for ice-cream cones. This price tends to persist through periods of prosperity and depression, through periods of high and low costs of production, through periods of high consumer incomes and low consumer incomes.[1] Variations may be made in the quality of the ice cream offered for 5 cts. and occasionally even in the quantity, but the price itself continues almost universally uniform. It is a consumer habit to pay 5 cts. for this article, and, under any but the most unusual conditions, that consumer habit persists. Efforts to raise the price would run into such determined opposition on the part of consumers that conditions of cost and supply are almost ignored, at least with respect to the price.

[1] In the industrial field steel rails furnish an excellent example of a price remaining unchanged over a long period. See Burns, *op. cit.*, pp. 205–211.

Retail Prices.—An examination of retail prices may throw further light on the factors which directly affect the formation of prices. The operator of a retail store decides at what price he will offer his merchandise after a rather complex series of calculations. He begins with a basic knowledge of what he paid for the merchandise. He also knows the cost of operating his store. He knows, therefore, that, if he wants to stay in business for any length of time, he must sell his merchandise at prices which will repay to him the basic cost of the merchandise, plus the cost of operating his store, plus a profit. The margin between the cost of the merchandise and the retail price he calls his "markup." That markup must be sufficient to cover his costs of operation and to return him a profit. It is interesting to notice, however, that a merchant may often sell part of, or all, his stock at a markup which is less than sufficient to cover the cost of operation. The practice of "loss leader" selling is widespread in the retail field. The merchant may sell at an insufficient markup in the effort to attract customers; to meet competition; to dispose of old, out of style, or spoiled merchandise; or to realize cash quickly for sudden emergencies. He does not determine his retail price by an analysis of supply and demand conditions. If his thoughts with respect to pricing could possibly be set down upon paper, they might follow such a pattern as this:

"I am in the men's clothing business. I am especially interested this morning in determining the retail price for this new lot of men's suits which arrived yesterday afternoon. I paid $20 for each of these suits. I know that the total expense of operating my clothing store amounts to about 28 cts. out of every dollar of retail sales. If I secure a markup of 33 cts. on every $1 of retail sales,[1] I know that I will cover my expenses of operation and probably secure a small profit. I will, therefore, plan a markup of 33 per cent on this basis. I will price at $30 each of these suits for which I paid $20 each. But can I secure $30 for these suits? I must think of a number of factors. In the first place, regardless of what I paid for these suits, will they

[1] This is commonly phrased as a markup of 33 per cent, markup being regarded as the relation of the difference between cost and retail price to the retail price. Formula: Markup in per cent = markup in dollars ÷ retail price.

look to my customers as if they are worth $30? In the second place, at what price are the other clothing stores in town selling similar suits? If suits which seem to be about as good as my suits are being sold in the next store down the street at $28.50, I may not be able to secure $30 each for these suits. On the other hand, if I price these suits at $30, my customers may not notice the difference in price between my store and the store down the street. Some customers, of course, will. I may sell a great many suits at $30 each, although, undoubtedly, I will not sell so many as I would if the competing store were not shading my price by $1.50 per suit. I must also consider the ill will which may be aroused among some of my customers when they notice the difference in price between my price and the price of suits in competing stores. Perhaps they will ask for some rebate after purchasing here. Perhaps they will think I am charging prices for my suits which are too high. Perhaps they will even think that all the merchandise in my store is offered at high prices. If that happens, not only will I suffer a decline in the sale of my men's suits, but my sales of hats, shirts, hose, neckties, and underwear may decline.

"Now I suddenly discover, after examining the offerings of competing stores, that suits similar to those I have just purchased are being offered at about $30 in several stores in this community. I have a further problem. If I price these suits at $30 I will be offering them at a price which secures an adequate markup for me and which will not suffer in comparison with the prices of similar merchandise in other stores. It might be advisable, however, for me to offer these suits at somewhat less than $30 and attempt to increase my sales by cutting under the competitive price. It is true that I will have to take a lower markup. On the other hand, I may compensate for this loss by securing increased sales. And yet, am I thinking soundly when I think like this? If I should offer these suits at less than, say $27.50 each, what will the other stores do? Will they maintain their $30 price and let me have an increased share of the men's suit business in this community, or will they cut their prices to meet mine? Will people think my suits are cheaper and continue paying higher prices to my competitors? Will it end with all the men's clothing stores in this community selling suits at $27.50, or will they in turn cut their price below $27.50 and will my action simply precipitate a price war?"

The trend of this merchant's thought covers practically every major problem to be encountered in the determination of retail prices. The merchant must consider, not only the markup[1] necessary to cover his costs of operation and to secure a profit, but also customary prices for such merchandise, competitors' prices for similar merchandise, convenient prices for such merchandise, the effect of his price policy upon the price policies of his competitors, the effect of his price policy upon sales of the merchandise in question, and last, and by no means of least importance, the effect of his price policy upon the permanent reputation of his store in his community. It is only after a consideration of all these factors that a merchant can determine his own retail prices.

Price Fluctuations.—The general topic of the formation of prices in wholesale and producers' markets can perhaps best be studied through a comparative analysis of price fluctuations in various phases of distribution. It has generally been observed that price fluctuations occur most rapidly and with the greatest magnitude in wholesale and producers' markets. For a number of products, wholesale markets are the most sensitive of all points of purchase and sale, with price changes occurring several times each hour, responding to every intimation of a change in market conditions. Price fluctuations in retail stores have generally been observed to occur most infrequently and with swings of the slightest magnitude. During a major depression, for instance, the most severe decline in prices is usually experienced by basic agricultural commodities. The least severe decline in prices is usually experienced in retail stores. The commodity exchanges which deal in the basic agricultural crops experience price fluctuations many times daily, and the fluctuations occurring from one day to the next may be of great severity. Retail prices, on the other hand, change rather slowly, and the changes, when they occur, tend to be gradual.

There are many forces underlying these price phenomena. Retail prices, perhaps more than any other prices, are governed by custom, habit, and convenience. The element of sharp bargaining which is present in the wholesale and producers' markets and the broad dissemination of market news are absent

[1] The relation between price and cost is discussed in Hamilton, *op. cit.*, pp. 536–543, and W. H. S. Stevens, Effects of Cost Analysis on Prices, *The Journal of Marketing*, July, 1938, pp. 62–70.

in the relation between retail stores and consumers. Their presence in the markets which shape wholesale prices and the prices of agricultural goods and producers' goods has a direct effect upon the rapidity of the fluctuations of those prices and upon the magnitude of the fluctuations.

Perhaps only on the organized commodity exchanges may conditions of perfect competition be found. Here alone, then, it is safe to explain price fluctuations as the result of the interaction of the forces of supply and demand. Elsewhere in the wholesale markets and in the sale of industrial goods an analysis which depends upon supply and demand conditions alone is not sufficient to explain price phenomena. As in retail stores, sales may be made for some period of time below cost. Here the bargaining power of large-scale buyers may exert an influence upon prices in such a way as to cause them to diverge from what might be regarded as normal relationships. Here as elsewhere in distribution the economist's concept of normal price holds true for the long-period outlook, but businessmen are constantly engaged in making estimates which are based upon market price.

Discounts.—In analyzing the formation of prices in producers' and wholesale markets, some attention should be paid to the discount policy of sellers. Quoted prices may bear little relation to prices actually paid because of the existence of a system of discounts throughout the business world. A variety of types of discounts are known, among which may be listed trade discounts, quantity discounts, and cash discounts. Trade discounts are discounts granted to buyers because of the economic position they occupy and the functions they perform.[1] A manufacturer who sells to both wholesalers and retailers may quote one price to retailers and another and lower price to wholesalers, justifying the latter price on the basis of the wholesalers' performance of certain marketing functions. Quantity discounts are discounts granted on the basis of the size either of the individual order or of cumulative orders during a specified period of time. A manufacturer may quote one price per case if less than 10 cases are ordered, a lower price per case if the individual order is in the range from 10 to 50 cases, and a still lower price per case if the individual order is for a carload. He may sell with a similar series of quantity discounts which are based upon total purchases

[1] Burns, *op. cit.*, pp. 277–280.

by individual customers during the period of 1 year. Such discounts are justified by manufacturers on the basis of the comparative costs of handling large and small orders.[1] Cash discounts are discounts offered for the prompt payment of bills.

The same bill of goods may involve all three kinds of discounts. One discount may be given because the purchaser is a wholesaler, another discount may result from the quantity in which he purchases, while a third discount may be allowed when the bill is paid within a certain time. Discounts may often amount to a very large proportion of the total cost of merchandise. Cash discounts alone have been known to mount as high as 10 per cent of the selling price. As a result of the importance of discount policies it is impossible to appraise a price policy without relating it to the granting of discounts in particular situations.

Basing-point Price Systems.—One further departure from normal supply-demand price formation is well worth examination. The pricing practice known as the "basing-point system" has played an important part in a number of the heavy industries.[2] The history of the practice in the steel industry may serve as an example inasmuch as it has become perhaps the most widely known of all the uniform basing-point price systems. Under the "Pittsburgh-plus" pricing system, steel manufactured outside Pittsburgh could not be sold for less than the Pittsburgh base price plus freight from Pittsburgh to the delivery point. A purchaser of steel located in Chicago and buying steel manufactured in a northern Indiana steel mill paid, under the "Pittsburgh-plus" system, the base price for steel in Pittsburgh plus the imaginary freight from Pittsburgh to Chicago. The greater the distance of the delivery point from Pittsburgh, therefore, the higher the price. No matter where a buyer was located, prices for steel as offered by all steel mills were uniform, equal to the Pittsburgh price plus imaginary freight charges from Pittsburgh to the delivery point.

In 1924 when the "Pittsburgh-plus" basing system was 18 years old the Federal Trade Commission, after an extensive investigation, ordered the steel companies to cease and desist

[1] Cowan, D. R. G., Differential Selling Costs in Relation to Wholesale Prices, *The Journal of Marketing*, July, 1938, pp. 71–76.

Learned, E. P., Quantity Discounts from the Seller's Point of View, *Harvard Business Review*, 1929, p. 65.

[2] Burns, *op. cit.*, pp. 280–371.

from this basing-point price practice. Some modifications of the basing-point system were introduced, and there developed what came to be known as the "multiple basing-point system" which was in essence the old "Pittsburgh-plus" plan extended to include not merely Pittsburgh but several other steel manufacturing points as base cities for the pricing plan.

The basing-point system of pricing was subjected to serious criticism for a number of years. The 1936 report of the Federal Trade Commission investigating the multiple basing-point system in the steel industry extended these criticisms, and many writers on economic subjects have concurred with the Federal Trade Commission. They have charged that any and all varieties of basing-point price practices lead to price discrimination, are imperfectly competitive and wasteful, lead to higher prices, introduce centralization of price control in the hands of the largest plants, and present a general picture of monopolistic domination of industry. The steel industry has defended this practice largely on the grounds that it widened the number of supply sources offering steel to any purchaser, and that in the long run the result of basing-point practice would be to decrease the prices of steel products. The rebuttal argument went on to point out that the abandonment of the basing-point practice would seriously handicap several of the largest and oldest steel-producing centers and would strengthen the position of the newer steel mills located nearer the major consumption points. It was indicated that it would lead to such a disturbance in the steel business that the effects upon both capital and labor employed in the industry would be extremely serious. The most extensive survey of the steel industry under the NRA codes[1] reached the conclusion that the continuance of the basing-point practice was justified, placing great emphasis upon the special production and distribution conditions to be found in the steel industry.

A very extensive discussion has proceeded for years among both economists and businessmen about the validity of such a basing-point price system. It has been argued, on the one hand, that the basing-point system increases competition; on

[1] Daugherty, DeChazeau, and Stratton, "Economics of the Iron and Steel Industry," Bureau of Business Research Monograph 6, published for the Bureau of Business Research, University of Pittsburgh, by McGraw-Hill Book Company, Inc., 1937.

the other hand, that it decreases competition. The Federal Trade Commission has reached conclusions inimical to the continuance of basing-point price practices. Other investigations have reached opposite conclusions. The substitution of multiple basing points for the single basing-point practice, exemplified by the "Pittsburgh-plus" system, seems to be a move toward a compromise between the two points of view. It does not offer satisfactory proof of its validity either for increasing competition in favor of consumers of products priced under the basing-point plan or for protecting established industrial organization for producers. The system has generally been confined to industries characterized by highly standardized, bulky products manufactured by a fairly small number of producers under conditions of heavy overhead costs. The basing-point system is obviously more satisfactory to producers than to consumers. It is far from clear, however, whether the interests of producers should and must be sacrificed in favor of the interests of consumers of steel and similar products.

Varieties of Price Policies.—A number of other specialized price policies which are encountered frequently in business deserve to be mentioned. One of these is the practice of offering purchasers guarantees against future price declines.[1] This situation typically arises when a purchaser is planning to enter into long-term commitments for the receipt of merchandise at prices determined at the date of purchase. At such a time the purchaser may be very anxious about future movements of prices. He realizes that, if prices should decline, competitors may be able to buy at more favorable prices and so place him at a disadvantage. When dealing with such a purchaser, the seller occasionally may attempt to induce him to purchase by offering guarantees against future price declines. He may assure the purchaser, either orally or through contract, that, if the price should decline in the future, he will be protected by being offered merchandise at the lowest price existing at the time future deliveries are made.

The practice is obviously one exacted from sellers by buyers who are in strong positions. It is, therefore, one more commonly encountered in times of slack than of rushing business. It may be a policy made necessary either by the nature of the

[1] Burns, *op. cit.*, pp. 200–202.

industry, by competitive practice, or by the desire to secure orders during periods of depression characterized by falling prices. Obviously it is one which shifts the risk of future price movements to the seller. More commonly found in the sale of industrial goods and in wholesale markets, this price practice has occasionally made its way into the retail markets where from time to time retail stores have offered such guarantees in the attempt to secure sales during periods of seriously depressed business. Such a policy does not appear to be one that any seller would adopt except under pressure. It carries with it such risks that, save where absolutely necessary because of business or competitive conditions, it is better left alone.

Another price policy commonly encountered in the retail world is sufficiently important to merit brief notice. It is the practice of offering consumers temporary price concessions at special sale periods. This policy may be introduced in the attempt to stimulate business during periods of cyclical, seasonal, or daily declines. Obvious examples are found in the increased offering of merchandise during depression periods, in off-season sales of merchandise at special low prices, and in the week-end offerings of cut-price merchandise by grocery stores. The practice is based upon the hope of securing increased sales of merchandise offered at reduced prices, and, in addition, of other merchandise at regular prices which may be purchased by consumers attracted to the store by the reduced prices.

Resale Price Maintenance.—Perhaps the most significant of recent developments in the pricing field is the movement toward resale price maintenance. Until the passage of the Miller-Tydings Act in 1937, attempts by manufacturers to control the resale prices at which their merchandise was offered to consumers were limited by the antitrust laws. Manufacturers, it is true, could refuse to sell to retail stores which persisted in cutting prices and could make sales on a consignment basis which, since it retained for manufacturers the legal status of ownership, permitted them to dictate retail prices. Beyond this general approach to the problem, however, manufacturers could not go unless they were prepared to assume the extra costs and risks of consignment selling and to sacrifice a number of potential outlets for their products. They had no effective control of the pricing policy of retail stores. The general theory was that, when

a manufacturer sold his products to a retail store, title passed from him to the retailer, and the manufacturer had no further interest in the merchandise.

In the years of depression following 1929, agitation against predatory price cutting developed. It was taken up particularly by the organizations of small retailers in a defensive struggle against chain-store price practices. These organizations were successful in pushing through fair-trade laws in a number of states and eventually in securing the enactment of the Miller-Tydings Act providing the necessary Federal enabling legislation. The gist of the fair-trade legislation lay in the permissive grant to manufacturers of the right to enter into contracts with retailers to fix retail prices of branded merchandise. The acts had two outstanding features in common. They were permissive, not mandatory. Manufacturers might, but were not forced, to write retail-price maintenance contracts. When a contract had been entered into between a manufacturer and a retailer in a given state, specifying resale prices for his merchandise, the terms of that contract were binding upon all retailers in the state whether or not they signed similar contracts. The Supreme Court's approval was secured for such legislation largely on the grounds that, although title passed from manufacturer to retailer on the sale of his merchandise, the manufacturer still maintained an interest in the merchandise through his brand name. The court accepted the argument that price cutting might eventually damage the reputation of a brand and so injure the manufacturer. To protect himself against such injury the manufacturer was permitted to extend his power over the price at which his merchandise was sold to consumers.

The problem of price maintenance is a complex one.[1] Not all manufacturers have been disturbed by price cutting. One view has been that, regardless of the effect upon retailers, price cutting sold more of a manufacturer's products and was therefore a desirable practice in so far as the manufacturer was concerned.

[1] The effect of price maintenance upon different types of middlemen is discussed by E. T. Grether in Fair Trade Legislation Restricting Price Cutting, *The Journal of Marketing*, April, 1937, pp. 344–354. The April, 1938, issue carries three articles discussing the same points: M. P. McNair, Fair Trade Legislation and the Retailer, pp. 295–300; H. E. Agnew, Fair Trade and the Consumer, pp. 301–302; R. E. Freer, Fair Trade in Operation, pp. 303–308.

The potential danger to a manufacturer's reputation working out through the effect of price cutting upon his brand name was regarded by many manufacturers either as nonexistent or as existing in the remote future. Price cutting was viewed much more seriously, however, by small retail outlets competing with chain stores. Chain organizations, particularly in the drug and grocery fields, commonly practiced price cutting of nationally advertised merchandise in the attempt to secure added patronage which might lead to increased sales of merchandise not subject to price cutting. The owner of a small tobacco store strongly objected to the practice of certain department stores and grocery chains engaged in selling tobacco products at cut prices. They could afford to sell such products at lower prices and suffer a loss on their sale if they could thereby effect an increase in the sale of other merchandise at profitable prices. The tobacconist could not, however, afford to meet such prices when he had to make a profit out of the sale of tobacco products alone. The general trend of thinking on the part of small retailers, therefore, was toward the maintenance of retail prices. They sought legal protection particularly after they realized that few manufacturers were in a position to offer an effective threat to chain stores by proposing to refuse to sell to organizations which persisted in cutting retail prices.

From the point of view of the organizations which habitually offered merchandise at reduced prices as leader items such a practice was a justifiable merchandising scheme.[1] It was compared with advertising expenditures as being simply one more device to attract customers. It was justified on the grounds that the retail merchant owned the goods which he had purchased and that his price policy was his own concern. The chain- and department-store world offered strong but ineffective opposition to the enactment of price-maintenance legislation.

In practice, price-maintenance legislation has not been a universal panacea. Manufacturers have been slow to yield to the pressure of independent retailers to write price-maintenance

[1] Walker, Q. F., A Retail Attitude toward Resale Price Fixing, *The Journal of Marketing*, April, 1937, pp. 334–343. The article by the economist for the nation's largest department store naturally regards the problem of price cutting and price fixing from the viewpoint of the large-scale retailer.

contracts. They have been fearful of competition from nonprice-fixed merchandise and from the private-brand merchandise sold in chains and department stores. Price maintenance has been confined largely to the drug, liquor, and publishing businesses and even here has not been wholly successful. In a number of states independent retailers, angered by manufacturers' refusals to enter into price-maintenance agreements, have forced the enactment of further measures designed to make such action mandatory. Such recent legislation has taken the shape of laws prohibiting the sale of any merchandise at less than delivered cost plus an added percentage designed to cover at least part of the cost of operation.

In the larger view all action designed to inhibit freedom in pricing must be regarded as detrimental to the full development of competitive economy. Although definite proof is lacking, there is available a body of evidence indicating that the general effect of price-maintenance legislation has been to raise the level of retail prices. The inevitable effect, if that evidence is sound, must be to decrease consumers' real incomes by reducing the purchasing power of their money.

Fortunately for the consumer, unbranded merchandise does not lie within the protection of the fair-trade laws.[1] In the case of merchandise which may be price fixed under these laws, the consumer usually has the choice of a nonadvertised substitute which carries a lower price.[2]

It would be the height of folly, of course, to condemn out-of-hand the movement for price maintenance. The sentiment naturally grows from the effects of competition on small-scale business and particularly, perhaps, on the less efficient units of small-scale business. The trend away from a competitive and toward a monopolistic basis for pricing is one of the most serious problems in current business. It is, unfortunately, a problem which does not lend itself to quick and satisfactory solution.

[1] Grether, E. T., Why Most Retail Prices Will Escape Control under Fair Trade, *Printers' Ink*, Feb. 17, 1938, p. 13.

Freer, *op. cit.* Drugs, cosmetics, books, and liquors are the chief products which have been priced under these "fair-trade" laws.

[2] Cassady, R. Jr., The Consumer and the Maintenance of Resale Prices, *The Journal of Marketing*, January, 1939, pp. 257–261.

CHAPTER XVI

COMPETITION

"The history of business is the record of one long struggle between the idea of competition and the idea of monopoly."

"We don't want 'chiselers.' We want clean competition."

"Of all strange things on land or sea—the devices of competition and the devices of quasi competition are the strangest."

"Competition is the life blood of trade."

The Place of Competition in Marketing.—To attempt a solution of the problem of price making by explaining it in terms of monopolistic competition certainly does not clarify the complex interaction of business forces. The business results which have grown from the basic idea of competition are yet to be examined. Their study leads the reader into another area in marketing. There are forms of nonprice competition which are both interesting in themselves and of vital importance in their effect on marketing practice. There are direct relations between the forms of competition and marketing costs. There are lines running from competition to the quality and the quantity of the merchandise offered to consumers. A study of the movements, variety, and costs of the services offered in marketing cannot be undertaken without reference to the results of competition as they affect distribution. The effect of competition upon research, upon the gathering and dissemination of market news, and upon the practice of standardization should not be overlooked. And finally, there is a close relationship between the extent of governmental interference with and regulation of business practices and the extent and variety of competitive devices which are actively used by business.

A number of these aspects of competition will be discussed in the present chapter. They may be said to cut directly across the main study of marketing practice inasmuch as they introduce almost every aspect of marketing and yet do not in themselves constitute a major marketing function. The effects of competition are present everywhere. It is often difficult, however, to single out the effects of competitive practices and clearly dis-

tinguish them from the effects of a number of other forces present in marketing.[1]

The Effects of Competitive Marketing.—Competition causes risk. As business moves from a monopolistic position to a position of greater competition, many of the risks of business increase. A businessman faces a certain degree of risk even if he holds a monopoly position. There is always the possibility that his customers will shift to substitute products. There is the possibility that his source of supply may fail him. There is the possibility that changes in the business cycle may adversely affect his own prosperity. He is relatively free, however, from a number of risks which are introduced directly by the active competition of other business firms. When competitors enter the business picture, they may practice price-cutting tactics. They may improve their products and make them more attractive. They may improve their packages. They may devise more effective and more efficient marketing programs, and they may seriously jeopardize a firm's control of its market. It may be true that for the consumer the effects can be regarded as beneficial. For the individual businessman the efforts must be regarded as risk producing and therefore as dangerous to the continued success of his business.

With monopoly conditions the businessman operates under little pressure to improve his products or the effectiveness of his marketing program. The force of competition necessarily directs his efforts toward realizing efficiencies which may lie within the range of possibility, but which have not yet been attained. The contrasting effects of competition in their impact on consumer and businessman suggest that there may be good competition and bad competition. This concept is relatively new in the field of economics and business. There was a time when both economists and businessmen were content to regard competition as a desirable economic state and to believe that active competition among a great many producers resulted in a general improvement in economic conditions for everyone concerned.[2] In recent years there has been a pronounced tendency to distinguish between good and bad competition.

[1] Alderson, W., A Marketing View of Competition, *The Journal of Marketing*, January, 1937, p. 189.

[2] Burns, Arthur Robert, "The Decline of Competition," Chap. I, McGraw-Hill Book Company, Inc., 1936.

The background of this trend of thought is extremely interesting. It introduces the concept of excessive competition together with the idea that competition when pursued too intensively may contribute to inefficiency. It has been claimed, for instance, that excessive competition may result in increasing marketing costs. It has been claimed that excessive competition may not be a benefit to the ultimate consumer. It has been claimed that excessive competition may be inimical to the social structure and the general welfare.

How Competition Affects Marketing Programs.—An examination of one aspect of this line of thought may serve to illustrate the tenor of the general criticisms. When a number of business concerns engaged in distribution first come into competition with one another, that competition is usually on a price basis; *i.e.*, one concern attempts to offer its product for less than competing concerns are offering similar products. In the retail field this development is exemplified by the introduction of new types of retail stores which usually appeal to consumers on the ground that they are offering merchandise at lower prices. As time passes all competing organizations may reach a common price level. All possible reductions in price have been made. The competitors, if they are manufacturers, may turn to improving the product; if they are merchants, to improving services. Under the stress of competition a product of better quality may be produced, the container or package may be improved, or, perhaps, a larger quantity may be offered with no change in price. After some time has passed, most of the possible improvements in product and package have been evolved. Again competition has reached a dead level. Business organizations may then turn to other competitive devices. Up to this point it is reasonably certain that competition has been, in general, beneficial and that a condition which might be termed one of excessive competition has not yet appeared.

When all business improvements which affect either the product or its container have been worked out, the forces of competition may direct the attention of business executives to the possibilities of making the conditions which surround the sale more attractive. In the case of retail stores this may involve the transfer to locations more easily accessible to consumers. These locations frequently involve paying higher rents.

More likely it may involve the improvement of store appearance and the purchase of more elaborate and attractive interior displays. It may also involve the offering of an increased number of services. All this is part of an attempt to impress consumers with the desirability of purchasing in one store rather than in another store, not because the merchandise is different, but because buying is more attractive in a particular retail organization.

In the case of a manufacturer whose marketing program has been evolved under the forces of competition, the program may continue through increased expenditures for advertising, through an enlargement of the sales force, and through the attempt to reach a greater number of retail outlets and to secure the good will of the operators of retail stores. Studies in the field of distribution have made it reasonably clear that when competitive practice directs itself toward making more attractive those conditions which surround the sale, the costs of marketing tend to rise. At this point it may be said that marketing appears to be entering the area where competition may be termed excessive.

It would be inadvisable, of course, to assume that the introduction of services is a sign of inefficiency. The modern consumer expects and demands a number of services with the merchandise she purchases. The offering of such services is in line with the best marketing practice. The area of inefficient or excessive competition lies beyond this point. It is that area where the multiplication of services and the piling up of selling costs exceeds the desires of consumers and emerges simply as the result of a battle for markets, a battle which contributes neither to the securing of larger markets nor to the reduction of total costs of distribution.

How Competition Affects Business Ethics.—The same general line of argument applies to the effects of competition upon business ethics. Business history records innumerable instances where competitive practice has degenerated into cutthroat activities which by almost any standard must be termed unfair competition. A number of these practices have been well defined by the Federal Trade Commission and measures have been taken against them both by the commission and by other governmental and trade-association bodies. To preserve a level of competition which is desirable from the standpoint of both

businessmen and consumers, restraints upon competitive practice must be set up. Such restraints may take the shape of direct legal control. Examples of this type of restraint may be found in the Federal, state, and local food and drug measures, or in various ordinances governing the supply of milk, inspection of meat, and the false labeling of various types of products. The restraints may also take the shape of rules of fair competition set up by trade associations. Under the National Industrial Recovery Act of 1933 codes of fair practice were set up in a great many industries, having as a partial objective the elimination of practices which were thought to be undesirable.

Among such unfair practices, at one time or another, have been included excessive price cutting, the deception of customers, the sale of inferior merchandise, and the use of deceptive or misleading advertising. It is difficult to assume that such results of competition are beneficial in the long run to anyone connected with the business process as producer, distributor, or consumer. An examination of such competitive business practice may lead without too great difficulty to the conclusion that uncontrolled competition is not wholly desirable.

Control of Competition.—With regard to the weapons of control there has been much debate. There is a school of thought which stands for self-regulation in business. There is another which believes that self-regulation can never be effective because of the absence of an active police force. Those who believe this favor one form or another of governmental intervention to force business practices to conform to a standard of fair procedure.

There is a third school of thought which doubts the efficiency of self-regulation. They also doubt whether governmental control and the establishment of exact rules by a state body can possibly handle the varieties of competitive devices developed in ordinary business procedure. They believe, that is, that it is impossible to legislate concerning something so intangible as competitive business practices. Those who hold this belief tend to favor general legislation which will, in effect, place the government in the position of an umpire who establishes general rules and seeks to interpret day-to-day business practices in the light of the immediate situation.

It is possible that the result, as far as marketing is concerned, will be an effective compromise between the proponents of

these various schools of thought. The compromise may work itself out through the control of certain competitive practices by business itself, through the control of other practices by specific legislation, and the control of a third type of practice by general legislation with administrative power placed in the hands of a government official. Analysis may, perhaps, go one step beyond this and maintain that, in the area where competitive practice affects only businessmen, self-regulation may be relied upon. In the area where business competition may directly affect and possibly injure consumers, specific legislation may be desirable. In the area where competitive practice is potentially dangerous to either businessmen or consumers, but where the danger may not be specifically localized and where self-regulation is not active, general legislation may be entrusted to an administrative body empowered to deal in various ways with specific competitive practices.

Against this background of theory it may be fruitful to examine in greater detail the records of various types of control extended over the general field of competitive practice.

The Common Law.—Under the common law prior to the era of the Federal Trade Commission Act certain commercial practices were held to be unfair. Among these may be listed fraudulent or coercive attempts to divert patronage from one concern to another, commercial bribery, defamation of commercial character, and similar practices. Conditions of modern competition apparently exceeded the power of the common law to deal swiftly and surely with the evils arising from excessive or misguided competition. As a result it became obvious that an attempt must be made to implement control before competition, which was in itself essentially a desirable business practice, acquired a number of undesirable offshoots. This attempt is represented by the Federal Trade Commission Act of 1914.

Federal Trade Commission.[1]—Under the Federal Trade Commission Act a governmental body was set up empowered

[1] Henderson, G. C., "The Federal Trade Commission," Yale University Press, 1924.

Blaisdell, T. C., Jr., "The Federal Trade Commission," Columbia University Press, 1932.

See also the *Annual Reports of the Federal Trade Commission.*

to deal with acts of unfair competition.[1] It was an agency to which injured parties might appeal and which possessed the power to issue orders for such practices to cease. Where the courts provided adequate remedy under common law, the Federal Trade Commission was not actively interested. The commission has, however, held a number of competitive acts to be unfair practice, in addition to those already so classified under the common law. Among these unfair practices may be mentioned combinations to control prices or markets, boycotts designed to limit the commercial freedom of businessmen, misbranding commodities, the use of misleading advertising, price discrimination, the use of secret rebates, and a number of similar practices.

State and Local Legislation.—Legislation affecting competition has been enacted in a number of states and by local governing bodies. Perhaps the best of such state laws have been the *Printers' Ink* statutes, so called because these state laws, directed against false advertising, were enacted largely as a result of the support of the trade publication *Printers' Ink* and of local advertising clubs. In general these attempts to weed out fallacious advertising have not been entirely successful. This has been due in great part to the difficulty of proving that fallacious statements were made consciously by the advertiser with the intent to deceive.

The work of the Better Business Bureaus set up in various cities and towns, in enforcing untruthful advertising laws and in ferreting out a great many undesirable practices, whether legal or illegal, should not be overlooked. Among the types of business and business practice which have been actively opposed by the Better Business Bureaus have been bucket shops, fake correspondence schools and collection schemes of various types, deceptive auctions, the sale of stolen merchandise, and the fraudulent organization of buying clubs which closely resemble lotteries.

Unfair Competition under the NIRA.—Under the NIRA were set up codes of fair practice which contained provisions governing

[1] The act stated that "unfair methods of competition in commerce are hereby declared unlawful" but did not define what was meant by unfair competition. It was left to the commission and the courts to interpret the meaning of "unfair methods of competition." A discussion of its meaning is found in Blaisdell, *op. cit.*, Chap. II.

price control, control of output and of markets, and a great many competitive practices which were described as unfair. In some of the codes attempts were made to render illegal the pricing of merchandise at less than cost plus a specified markup. Some codes went so far as to set specific prices at which merchandise could be sold. A number of the codes set up open-price associations. Under these agreements members of an industry filed price lists with code authorities and the use of prices not reported to the code authority was termed unfair competitive practice. The result of all such provisions may be loosely collected under the term "price fixing."

It was, of course, difficult to control prices without at the same time attempting to control output. As a result many of the codes contained provisions specifying the number of hours per week which labor might work, the number of shifts which a factory might operate, the conditions under which new equipment might be installed, and the conditions under which new capital might be permitted to enter a field of business. The general results of such provisions were to freeze the industrial structure at the existing level and to implement the power to regulate and fix prices.

An attempt to control the market was made in a number of the codes. Sellers were at times empowered to use the technique of the commercial boycott of undesirable customers, business tactics which prior to that time had been in the list of unfair practices. Many of these code provisions involved the temporary suspension of the antitrust laws. They were offered as desirable provisions during a period of national emergency. The general trend of that period was greatly to increase the power of trade associations and to legitimatize practices which up to that point had been regarded as destructive of competition.

The ramifications of the various provisions under the NIRA are so complex that it is difficult to reach a clear-cut decision on the act itself. Doubtless many of the provisions were genuinely helpful in clarifying the competitive business situation. Doubtless a number of the other practices tended so strongly toward monopoly as to be potentially dangerous for consumers. After the act was ruled unconstitutional by the Supreme Court a number of the codes of fair practice were continued. Through

their agency a measure of self-regulation has been extended to a substantial part of American business. In large part this represents a gain, particularly in the field of the voluntary outlawing of obviously wasteful and destructive competitive practices.

Competition under the Robinson-Patman Act.—Further limitations were placed on free competition by the Robinson-Patman Act of 1936.[1] This legislation was instigated largely as a result of the activities of a number of associations of small retailers. These businessmen, as well as many wholesalers whose successful future operations were tied up with the continued profitable operation of small retail stores, claimed that manufacturers were granting extra quantity discounts to large retail purchasers. They objected that such discounts were far in excess of any legitimate quantity discounts which could be justified by the economies of large-scale selling. In addition, it was claimed that advertising allowances were granted to large purchasers which were not available to small purchasers. The act attempted to limit price differentials to those which could be justified by the costs of selling to different purchasers. Discriminatory quantity discounts were ruled out under the law. The burden of offering proof to justify quantity discounts was placed upon the manufacturer. The act also prohibited the granting of promotional or advertising allowances unless offered on proportionately equal terms to all other customers.

There is little doubt that the portion of the Robinson-Patman Act which is directly concerned with discriminatory quantity discounts is a desirable piece of legislation. The chief difficulty connected with it, however, is that of enforcement. Few businessmen engaged in distribution have an accurate knowledge of the costs of selling single items in their line or of the comparative costs of selling to large and small customers. The technique of cost accounting, so thoroughly developed in production, has up to the present been applied only intermittently to marketing. The difficulties of interpreting marketing expenses on an accurate cost-accounting basis are numerous. In production the majority of costs are incurred more or less directly as a result of manufacturing activities. The burden of indirect costs which must be allocated along arbitrary lines make up, in general, a small part

[1] Engle, N. H., Implications of the Robinson-Patman Act for Marketing, *The Journal of Marketing*, October, 1936, p. 75.

of total costs. As a result the inaccuracies which may creep into cost accounting through carelessness or unreliable allocations tend to be minimized.

In marketing, however, just the reverse is true. Many of the costs are of an indirect nature. The problems of allocation are so difficult that in only a few instances has an approach to a satisfactory solution ever been attempted. Few manufacturers are prepared to appear before the Federal Trade Commission and justify by reference to cost records a scale of quantity discounts granted to their customers, which discriminates in favor of the larger customers. They know that it is less expensive to sell to large purchasers. Very few know, however, how much less expensive it is.

If the technique of cost accounting can be developed in such a way as to provide accurate expense records for distribution, there can be little doubt that the elimination of discriminatory discounts is desirable. It will not act to lessen competition. The difficulties of enforcement, however, are so great that results other than those foreseen by the framers of the legislation may be encountered. A number of writers have predicted that one of the results of the act will be to effect a cleavage between manufacturers. Some will sell only to small customers and others only to large customers. In this way the difficult problem of justifying quantity discounts will be avoided.

Commercial Arbitration.—Certain other extralegal devices for controlling, curbing, or aiding in the development of competitive business practice should be noticed. Among these may be listed the development of commercial arbitration, the activities of trade associations, the growth of the practice of grading and standardizing merchandise, and the dissemination of market news.

Commercial arbitration[1] is the technique of settling disputes by civil conferences rather than by resort to the courts. The practice, which has developed in recent years, is to a large extent an outgrowth of the delays which hamper business when it resorts to the legal solution of difficulties arising out of competitive practices. In addition to the delays in rendering decisions, which may seriously handicap business enterprise over an

[1] Bloomfield, D., "Commercial Arbitration," H. W. Wilson Company, 1927.

extended period, the courts frequently have not had the intimate knowledge of particular lines of business necessary for an intelligent solution of the problems presented. The legal process is an expensive one. Arbitration by mutual agreements may be secured at a relatively low cost.

Although the practice of arbitrating disputes is not new, its widespread use is one of the more recent developments in business. The American Arbitration Association has spread into more than 1,500 cities, and its panels of expert arbitrators contain over 5,000 names. The use of the arbitration method is, of course, dependent upon the mutual agreement of the parties to the dispute to accept the results of such arbitration. The disputants have the benefit of a quick solution rendered by an expert who understands the technicalities of the particular trades which are involved. Perhaps the major weakness in the practice of arbitration is the fact that in a number of states the laws do not compel the disputants to accept the decision of the arbitrator. Some improvement in this situation might be secured by the extension of state laws which would grant to disputants the right of appeal only if evidence of fraud can be produced.

Trade Associations.[1]—There are in this country nearly 7,000 trade associations including both national and local groups.[2] The movement has had an amazingly rapid growth in recent years. The associations in general have had a common purpose, which is to promote the business of the various industries or trades by establishing standards, by the cooperative solution of mutual problems, and by the compilation and distribution of information.

Perhaps the most important work of many of the trade associations has been carried on in the field of standardization, simplification, and grading.[3] Under the stress of direct competi-

[1] "The trade association is a non profit organization (or sometimes an informal grouping, since the degree of organization is not fundamental) of business competitors for the promotion of one or more economic interests in the line of business, or of the members, in the territory covered."—Open Price Trade Associations, Federal Trade Commission Report, p. 1.

[2] Converse, P. D., "Elements of Marketing," Chap. XXXVI, Prentice-Hall Inc., 1935.

[3] Kirsh, B. S., "Trade Associations in Law and Business," Chap. V, Central Book Company, 1938.

Burns, *op. cit.*, Chap. II.

tion the tendency throughout the business world has been to multiply the varieties and types of merchandise offered to the consuming public. At times this has gone so far, through attempts of manufacturers and distributors to individualize their products, that a substantial amount of economic waste has resulted. The economies in the production and distribution of uniform commodities have been sacrificed, costs have risen, and the utility to consumers has been negligible in comparison with the higher prices necessitated by the multiplication of varieties of merchandise. The movement toward simplification and standardization, adopted by a business rule of reason and worked out in many cases through the various trade associations, has been influential in reducing production and distribution costs. Standardization in turn has eased the task of maintaining established grades. The general movement can be offered as evidence of the constructive work carried on by trade associations.

A second valuable contribution of trade-association activities has been the sponsorship of business research. The largest independent business concerns are, of course, in a position to carry on their own research. Most business concerns, however, find their research activities limited by the funds available. Inasmuch as the results of research can usually be profitably used by all concerns in an industry, the logical organization to sponsor research is the trade association. In many industries the results of research have been directly applied to the improvement of marketing methods and to the reduction of costs with resultant benefits for the ultimate consumer.

A number of the trade associations have been actively interested in pricing problems. This aspect of their work has perhaps been more open to criticism than some of the other activities described above. Trade-association activity in the field of pricing has expressed itself in various forms among which may be listed direct attempts at price fixing, oral agreements for the control of prices, and the establishment of open-price associations. The first of these three types of pricing activities has generally been outlawed because of legal restraints. Much greater efforts have been made toward price controls operating through what have been called "gentlemen's agreements" and open-price associations. Pricing by agreement is usually the result of industry dominance by one or two large concerns whose price

schedules are followed with little challenge by the smaller concerns. Open-price associations[1] have been organized as agencies for collecting price, production, and marketing information voluntarily filed by the members. Such information is available to all members.[2] It may result in more intelligent planning and marketing. It may result in a lessening of active price cutting, inasmuch as all price reductions must be immediately made public. It is realized that publication of price reductions will be followed by similar reductions by the other concerns in the industry. This situation obviously tends toward price maintenance.

The results of many of the activities of trade associations are beneficial for the general public as well as for those active in the trade. This is particularly true in so far as the associations make possible a more rational approach to the problems of production and distribution. Trade-association activities in the field of pricing, however, cannot always be viewed without protest.

From the standpoint of the general public and its stake in the maintenance of competition, trade associations must be dealt with as organizations active in both desirable and undesirable ways. There is offered again an example of constructive and destructive competition which is found so often in the various divisions of distribution.

Market News and Research.—One development in marketing which is firmly grounded in the stresses of competitive practice is the modern movement toward the collection and dissemination of market news. As markets have been extended, uncertainties and risks have multiplied. Partial control of risk may result from the acquisition of knowledge about markets and people. The necessary activity of gathering news about markets and people has been carried on by governmental agencies, by private financial institutions, by educational institutions, by trade associations, and by independent companies.[3] The sum total

[1] Open Price Trade Associations, Federal Trade Commission Report, 1929.

[2] H. S. Dennison and J. K. Galbraith, "Modern Competition and Business Policy," Oxford University Press, 1938, pp. 91–93, express the viewpoint that the various factors entering into price should be given publicity to everyone.

[3] The student who is interested in keeping abreast of the marketing-research studies of these various agencies will find them reviewed under Progress in Marketing Research, in each issue of *The Journal of Marketing*.

of this work has been an indispensable aid in the improvement of the market, in the diminution of risk, and in the control of the marketing process.

Closely allied to the gathering of market news is the sponsoring of market research.[1] Market news may be defined as the activity of assembling and disseminating information pertaining to prices, supply and demand conditions, weather conditions, crop conditions, crop reports, and similar information. Market research involves a more complete and extended investigation into topics not normally covered by routine published reports. Market research delves into conditions which surround particular products or which affect the distribution policies of particular companies.[2] Frequently market research involves the use of material prepared by public or financial institutions or by trade associations. As the early chapters of this volume have indicated, marketing based upon adequate news and research can be characterized as modern marketing.[3] These conditions may be contrasted with marketing methods of the past which have been handicapped by lack of knowledge and which, therefore, have assumed the burden of those risks which vary with the possession of market information.

[1] "The Technique of Marketing Research" McGraw-Hill Book Company, Inc., 1937.

[2] Haynes, E., The Value of Market Research to Industrial Marketers, *The Journal of Marketing*, October, 1938, p. 180. This article discusses seven benefits resulting from market research.

Carroll, J. F., The Value of Marketing Research to Corporate Chains, *The Journal of Marketing*, October, 1938, p. 184.

[3] Frederick, J. H., New Uses for Marketing Research, *The Journal of Marketing*, October, 1937, p. 132. This discusses some "novel uses of marketing research."

CHAPTER XVII

COST OF MARKETING

"The first line of social criticism of our economic life is this: distribution costs are too high."

"The fact is that society has unconsciously placed a heavier and heavier burden upon the marketing structure resulting from such changes as the growth of urban centers, the widespread advances in communication and transportation, and the expansion of the national income, all culminating in greater demands for marketing services. All these changes have had the net effect of magnifying the task of distributing the goods which we have learned to produce with growing ease and efficiency."[1]

What Is the Cost of Marketing?—The analysis of the cost of marketing is not a study for cost accountants alone. It is a problem which confronts every business executive. It is not, unfortunately, a problem which lends itself to easy solution. The factors to be dealt with are so complex, the business scene which is examined so dynamic, that the exacting science of cost accounting finds it difficult to offer accurate quantitative measurements.

We do know a good deal about the cost of marketing. As a result of a number of generalizing estimates, we may hazard the guess that in 1935 total marketing costs were in the range of from 15 to 15½ billion dollars.[2] It may be estimated that approximately 40 per cent of the total value of manufactured products was expended in production as compared with approximately 33½ per cent expended in marketing. In that year marketing costs amounted to about 28 per cent of total income payments. Production costs were approximately 33 per cent of total income payments. A further breakdown of marketing costs, again on the basis of estimates, indicates that of total marketing costs retailing cost alone accounted for about 56 per

[1] "Distribution Cost Analysis by Commodities," an address by Nathanael H. Engle at the Ninth Boston Conference on Distribution, 1937.

[2] *Ibid.*

cent, wholesaling cost for about 29 per cent, and manufacturers' marketing costs for about 15 per cent.[1]

Cost of Marketing Potatoes.—If we direct our attention to specific products, a number of further estimates may be made. One examination of the distribution of consumer payments for potatoes indicated the following facts. As we trace the potatoes from the grower to the consumer and see the many hands through which they pass, together with the services which were rendered and the costs involved in each case, we see how the retail price is built. All these costs enter into the price which the consumer pays. A grower received 60 cts. a bushel for potatoes after harvesting. He sold the potatoes to a shipper who assembled from a number of growers and forwarded to urban wholesalers in carload lots. The receipts of the shipper were 10 cts. per 100 lb., or about $36 a carload. From this amount he had to deduct a $3 inspection fee which also covered losses due to shrinkage. The shipper forwarded the potatoes to a broker and paid him $15 a car as a commission. On this basis it was estimated that the net profits to the shipper amounted to about 2 cts. per 100 lb. It was also estimated that the broker secured a net profit of 1 ct. per 100 lb. Freight charges amounted to 60 cts. per 100 lb., and heating expenses in transit to 6 cts. per 100 lb. The wholesaler paid $1.36 per 100 lb. for the potatoes. His selling expenses amounted to 15½ cts. per 100 lb., making the total cost of the potatoes $1.51½ per 100 lb. The wholesaler sold the potatoes to retailers at $1.55 per 100 lb.

The retailers sold the potatoes at 9 lb. for 25 cts. This price, however, was applied to evenly graded potatoes for baking. It was necessary, therefore, for the retailer to divide his shipment into three classes and to price them at varying levels to reflect their value to consumers for different uses. The retailer received $2.11 per 100 lb. for the potatoes which cost him $1.55 per 100 lb. The expenses of operating his retail business amounted to about 15 cts. per 100 lb. This left the retailer a profit of a little over 14 cts. per 100 lb.[2]

We can look at the same picture from another angle. The consumer pays $1 for some potatoes. We can then figure

[1] The Quantitative Position of Marketing in the United States, *The Quarterly Journal of Economics*, May, 1935, pp. 394–413.

[2] Rice, Millard Milburn, Hawkshaw Shadows the Potato, *The Nation's Business*, August, 1935.

the various costs mentioned above as percentages of the price paid by the consumer. This is spoken of as the division of the consumer's dollar. These component elements can be shown easily in chart form.

Cost Analyses Frequently Are Approximations.—Similar analyses may be carried on for a number of different types of products. The results will, of course, vary from time to time and from place to place. In many instances even the most careful analysis will reveal only general approximations of cost inasmuch as the difficulties encountered are so great as to prevent the businessman from securing that accuracy which he has come to expect from the application of cost-accounting techniques to production. However rough the calculations may be, there is little doubt of the desirability of moving toward a solution of the problem of marketing costs. Such information will be of great value, not alone from the social point of view as evidence to prove or disprove major criticisms of marketing institutions, but also from the standpoint of affording the tools for the economic control of business, for the location of waste in distribution, and for the determination within a single business concern of a suitable marketing policy.[1]

Without knowledge, administration is blind and helpless. The provision of rough estimates of marketing costs gives to executives a tool without which they can do little to reduce the cost of marketing.

The Purpose of Cost Studies.—The results of the analysis of marketing costs may be used to compare the relative efficiencies of several concerns operating in the same industry. They may also be employed to compare the relative efficiency of several branches of one concern in different parts of the country, or to compare the relative efficiency of distribution through alternate channels. They may become the basis for the determination of discounts. They offer at least one major criterion for the evolution of a system of marketing and, at all times, they provide the material for an over-all inspection of marketing.

[1] "By revealing waste and inefficiency in existing operations, cost analysis may serve to reduce abnormally high prices as well as to increase abnormally low ones. This is especially true wherever the cost data are exchanged between companies in an industry so that cost comparisons are possible."—W. H. S. Stevens, Effects of Cost Analysis on Prices, *The Journal of Marketing*, July, 1938, p. 62.

Cost studies may be carried on by trade associations, by educational or governmental institutions, or by individual business concerns. Attempts to analyze costs must inevitably lead to refinements in the application of cost accounting to marketing and so provide a background for more accurate cost studies to come in the future.

Difficulties Involved in Cost Studies.—Some examination of the difficulties commonly encountered in analyzing marketing costs may be helpful. One common difficulty is that which arises from the confusion between marketing activities and production activities. It is necessary to establish a clear-cut differentiation between what is production and what is marketing and to make certain that the costs allocated to marketing are only those which arise from marketing activities. The problem of deciding whether packaging costs are production or marketing costs is an example of this difficulty. A further difficulty arises from the problems of comparing marketing costs in different business concerns or in different areas. To meet this problem, it is necessary to place all costs on a percentage basis. Dollar comparisons are meaningless when varying sales volumes are present.

In connection with the process of comparing cost, other problems are encountered. The comparison of marketing costs between one industry and another may be meaningless. The marketing process in one industry may have no relation to the marketing process in a second industry. For effective analysis, therefore, it is desirable to make comparison only for concerns operating in the same industry and under the same general conditions of distribution.

Still another difficulty encountered in analyzing marketing cost arises from the problems of handling those items commonly described as "joint costs." This difficulty is obviously present in the problem of allocating to the various products he sells the salary and traveling expenses of a salesman promoting a wide line of products.

Difficulties of this type bring out clearly the differences in applying cost accounting to production and to marketing. Broadly speaking, in the field of production, most costs are direct costs. Broadly speaking, in the field of marketing, most costs are indirect costs. In production, relatively little allocation of

costs has to be carried on. In marketing, a relatively large amount of allocation has to be made. It may be generalized that the difficulties and the inaccuracies of cost estimates vary directly with the proportion of indirect cost allocations which must be made.

Variations in Costs of Marketing.—Marketing costs vary product by product. In the marketing of farm products,[1] we find an impressive range in distribution costs extending from less than 15 per cent to more than 50 per cent of the price paid by consumers.[2] A large part of the variations in cost can be traced directly to specialized marketing conditions which may be analyzed. Higher costs of distribution are found where one might expect them. Perishable agricultural products, particularly those produced at a distance from major consuming markets; products which are subject to losses from shrinkage; products which are marketed under conditions of uncontrolled supply and demand; or those which are handicapped by a lack of information with regard to current supply and demand conditions, all tend to assume a higher burden of marketing costs. On the other hand, those farm products which are fairly uniform, which are standardized, which may be stored, which are relatively nonperishable, and which are marketed under conditions of widespread market news tend to have somewhat lower cost of marketing.

The same general conditions may be discovered in analyzing the cost of marketing manufactured goods. Again there is a considerable variation in costs which can be traced to the special conditions which surround the distribution of different types of manufactured merchandise. Products which are sold to widely scattered consumers tend to have high marketing costs. So do those products which fall into the general classification of specialty goods, a type of merchandise which requires unusually aggressive and extensive selling efforts through both advertising and personal salesmanship.

[1] Been, R. B., and F. V. Waugh, "Price Spreads between the Farmer and the Consumer," U.S. Department of Agriculture, 1936.

[2] In 1938 the farmer's share of the consumer's dollar spent for a representative list of 58 foods was 40 per cent. *The Agricultural Situation*, February, 1939, p. 11. This publication is issued by the Bureau of Agricultural Economics, U.S. Department of Agriculture.

High Retailing Costs.—If the distribution of merchandise is further broken down into the field of wholesaling and that of retailing, one discovers that costs of retailing are much higher than are wholesaling costs. In many instances retailing costs may amount to as much as 35 per cent of retail prices. We have already pointed out[1] a number of reasons for the growth of the costs of operating retail stores. Perhaps of equal significance is the comparison of retail costs in stores of different types and also in stores of the same general character, selling similar merchandise.

Analysis appears to indicate that a number of the variations in retail costs may be traced directly to the degree of efficiency of operation. The continuance in business of the less-efficient retail outlets, whether as a result of protective legislation or of consumer ignorance or inertia, transfers to the general body of consumers the cost burden of this inefficiency. The same statement, of course, may be made with regard to every other division of the distributive process where wastes occur. The fact that retailing costs are unusually high, however, tends to localize these charges of inefficiency and to point up the criticism of retailing as one of the more inefficient areas in the field of marketing. There is much truth in the general proposition that the greatest opportunity to reduce the costs of marketing lies in the elimination of waste.

Low Cost of Marketing Industrial Goods.—A further comparison of the cost of distributing the general class of consumers' goods with the cost of distributing industrial goods reveals a pronounced advantage in favor of industrial goods. Industrial goods tend to have somewhat lower marketing costs than do consumers' goods.

A number of general characteristics for production goods may be referred to in explaining this situation. Among them may be listed the extent of marketing information possessed by buyers and sellers, standardization of merchandise, the close connection between buyers and sellers, the absence of widespread selling efforts, and the size of the individual order.

The presence of these characteristics in the distribution of production goods provides a setting for low-cost marketing. The absence of some or all of these characteristics in the distribution

[1] See Chaps. VIII and IX.

of consumers' goods provides a setting for high-cost marketing. The range between low-cost marketing and high-cost marketing may be measured by the number of these factors which are present in any given marketing situation.

Major Elements in Marketing Costs.—The analysis of marketing costs may be carried further by an examination of the major elements which enter into the cost structure. Among these elements may be included transportation, rent, wages and salaries, depreciation, insurance, advertising, and taxes, as well as a number of other factors of varying importance. They enter to varying degrees into the operation of different types of businesses. The total cost of operating a wholesale house as a percentage of sales may be low. The total cost of operating a retail business as a percentage of sales may be high. The extent to which each of the major elements in marketing costs enters into total cost may determine the relative efficiency of any business concern.

Comparing Cost Percentages.—To take but one example, in the operation of a full-service retail store the total expenses may amount to as much as 30 to 35 per cent of sales. Salaries and wages alone may account for as much as 18 per cent of total sales for some types of full-service retail stores. Rental costs sometimes rise to 6 per cent of retail sales. Advertising costs may account for as much as 4 per cent of retail sales.

If comparisons are made within any one type of retail establishment, it may be found that those stores which record the best performance from a profit standpoint are those which reveal relatively low percentage expenditures for salaries and wages. This may be interpreted as indicating that some stores secure more efficient performances from their employees. The index of this efficiency may be recorded as the volume of dollar sales made by the average salesperson. The same class of stores operating with relatively low-rent costs may measure the efficiency of operation in terms of rental charges by the index of sales per square foot. The efficiency of advertising may be measured in terms of sales per dollar spent for advertising.

A comparison of results from store to store on a percentage basis, therefore, will reveal that some stores spend more for salaries, advertising, rent, and other expenses while other stores spend less. The expenditure in dollar amounts alone is not a

true measure of efficiency unless stores have the same dollar volume of business. The relation of the expenditure to results in terms of sales and profits does serve, however, as a measure of efficiency. It is very helpful, therefore, for the operator of one store to compare operating results in his own store on a percentage basis with the operating results in other stores selling merchandise of the same type, offering similar services, and operating under roughly similar conditions in communities of about the same size. By making this comparison, a store owner is presented with visual evidence of the comparative standing of his own store. Perhaps more important, he is given definite leads for running down and isolating waste areas and points of inefficient operation within his own store. Only by the practice of isolating waste areas will he be enabled to direct his attention toward remedying inefficient operations.

Marketing Costs Divided into Two Groups.—As a result of this type of analysis, certain tentative conclusions may be reached concerning inefficiency in marketing and some attempt may be made to answer the general criticism that marketing costs are too high. Marketing expenses may be divided into two general classifications: those expenses which are high for known reasons and which may be reduced, and those expenses which are high for unknown reasons or which do not as yet lend themselves to reduction. In the first classification we may place all those costs of distribution which are incurred as a result of catering to established consumer buying habits. Here may be listed the expenses of offering the various types of services which consumers require. Here, too, may be placed the expenses incurred in providing the varieties of goods which consumers appear to demand, the constant display of new styles, the offering of merchandise at several price lines, the location of stores at convenient points, and every other attraction, whether of merchandise or of service, which appears to be offered as a result of consumer demand. The plain fact is that we know how to reduce expenses incurred in this way. The fact that these expenses are not reduced may be directly traced either to established consumer buying habits or to competition between sellers on a service basis. It is apparent that large numbers of consumers prefer to buy in this way and are willing to pay the extra cost.

The second general class of expenses may be directly traced to inefficient marketing. Into this classification fall all those marketing expenses which are incurred as a result of a lack of knowledge, the failure to apply scientific techniques to the administration of business enterprises, the presence of insufficient capital, failures in foresight, and every type of waste which results from inattention or carelessness. In this area it is correct to assert that marketing is inefficient. We do not have the necessary knowledge, or, where it is present, that knowledge is not carefully applied to the solution of marketing problems. It is in this area that in the future one may expect the greatest contributions to increased efficiency.

Reducing Marketing Inefficiency.—By what methods may one expect the inefficiencies in marketing to be reduced? Perhaps the most important direct contribution will lie in the improvement of accounting and statistical methods and techniques. It has been said that many of the numerous marketing failures which occur every year are the direct result of a lack of knowledge of the costs incurred in operating a business. This is purely an accounting problem. To operate at a profit, a businessman must know his costs. Only by knowing his costs will he be able to dispose of his merchandise at prices sufficient to yield him profits.

The argument that accounting techniques in marketing must be improved is directed not only to the relatively simple accumulation of facts regarding total costs of operations and costs broken down by major expense divisions. It is also directed to the accumulation of information with regard to the relative costs of selling to large and small accounts, to the costs of doing business at varying distances from the point of sale, to the costs of selling direct and through middlemen, and to every other type of cost differentiation which may occur in distribution.

This suggests the second method for reducing the inefficiencies of marketing. A comparison of statistics summarizing the operations within one business may be made with statistics summarizing operations of other business concerns which are carrying on parallel functions. By the comparison of operating results of concerns in the same industry, executives may secure the information necessary for distinguishing between efficient and inefficient concerns. By continuing the comparison to the point of breaking down total-cost statistics into minor sub-

divisions, such as the comparison of rent expenditures, selling pay-roll expenditures, nonselling pay-roll expenditures, and accounting expenditures, the operator of a business may be assisted in localizing high-cost departments within his own business. He may be able to learn, that is, in what specific parts of his business the costs of operation are unusually high. By directing his attention to those areas of inefficiency, it is possible that he will be able to improve operating conditions and to lower costs.

Together with this comparison between individual operating statistics and average figures for the industry should go a comparison with a business concern's own past history. The progress of a concern from year to year may be traced, with the cost breakdown extended to minor subdivisions of total expenses. Again the object is to localize inefficiencies and high costs by directing attention to departments at fault.

This type of analysis of business operation on a cost basis may well lead to a substantial improvement in operating results. This may be particularly true when the businessman is dealing with those costs which are high, not because of the necessity of catering to consumer demand, but because businessmen have not yet learned how to segregate the inefficient sections of their business and how to improve operating conditions. It is not entirely impossible, indeed, that the years to come may indicate not that marketing costs are too high, but that marketing costs should be increased; *i.e.*, further analysis may show that a greater contribution to social welfare and a wider and more efficient distribution of the goods of our factories and farms may result from increased attention to the complex operations of distribution. In connection with this point the reader should bear in mind that increases in marketing costs are socially desirable when they make possible greater decreases in production costs.

Reducing Marketing Costs by Educating Consumers.—A number of proposals have been made for reducing the costs of marketing. As usually occurs in dealing with major criticisms of economic and social institutions, some of the proposals have been more sensible than others. It may be worth while to examine most of the major proposals and to attempt to discover the extent to which they contribute to a more efficient marketing process.

One type of proposal centers around a program for educating consumers and making them wiser purchasers.[1] This represents the goal of the contemporary movement for furnishing consumers more information about the merchandise they buy. On the whole, the proposal offers benefits, in that it assists consumers in distinguishing between good and bad merchandise, in purchasing in a more rational manner and in concentrating buying on those types and brands of merchandise which offer the best values. It may eventually aid in weeding out less attractive types of merchandise and those brands which are overpriced and which in any way offer consumers less for their money. It must be recognized, however, that this is at best a slow process. It would take years of effort to bring consumer purchasers to the rational level which has been reached by industrial purchasers.

Reducing Marketing Costs by Improving Production.—A second proposal for reducing marketing costs centers around the increased application of rational managerial techniques to production. The argument runs that by standardizing and simplifying merchandise lines, not only can production costs be reduced, but a decrease in marketing costs may also be achieved.[2] This follows from the theory that, to a large extent, marketing costs are increased by the increase in competition; that just as production costs are reduced through a simplification process which enables factories to produce large lots of standardized merchandise, so marketing costs are reduced by a simplification process which enables salesmen to concentrate on selling one type of merchandise.

The increased use of standards and of standardized merchandise would also contribute, it is pointed out, to a lowering of marketing costs. This would work itself out through the increased ability to sell from samples and through consumer dependence upon the receipt of uniform merchandise. This type of proposal appears to offer some prospects for securing minor economies in distribution costs. It must be recognized, however, that it runs directly counter to the observed tendency

[1] Montgomery, D. E., The Consumer Looks at Competition, *The Journal of Marketing*, January, 1937, p. 218.

[2] Nash, B., Product Development, *The Journal of Marketing*, January, 1937, p. 254.

of consumers to prefer styles and a wide variety of merchandise from which to make selections. The consumer market may possibly be divided into two sections, one of which prefers variety and style and is willing to pay for these services, while the other prefers to buy as cheaply as possible and is willing, in the interest of economy, to sacrifice variety.

Research Helps Reduce Marketing Costs.—A third proposal for reducing marketing costs indicates that improvement in distribution may come from increased application of the techniques of marketing research. As manufacturers learn more about the markets in which they sell, the control of their marketing activities progresses toward a more scientific basis. As the agricultural interests learn more about the markets in which they sell, they become better able to adapt their products to those markets. They have information which is helpful in guiding shipments. There is little doubt that the inefficiencies of marketing must yield to the increased application of research techniques. The speed with which this may be accomplished, however, may at times be overrated, particularly by those who are likely to be dazzled by the prospects presented by any use of the word "science." Research is a valuable aid to efficient marketing. The application of the results of research to marketing methods have assisted company after company to reduce marketing costs. But this has not been accomplished overnight. We can expect in the future a continuance of the direction of the energies of experienced men into the analysis of marketing methods. It is not advisable, however, to expect a sudden drastic drop in marketing costs.

Relation between Competition and Marketing Costs.—A number of the critics of the marketing process have directed their attention to the effects of competition upon the cost of distribution. It has been maintained, for instance, that competition when carried too far acts to increase marketing costs. There are, certainly, aspects of competition which may contribute to increasing marketing costs. If one contrasts conditions of competition with conditions of monopoly, however, it is difficult to reach the conclusion that the removal of competition will be an aid in increasing the efficiency of marketing.

The possible effects of competition on the marketing of various types of products will bear further investigation. The

results may be found to differ, industry by industry. It would be inefficient to permit competition in the provision of such public services as light or water. It would be inefficient, that is, to permit two electric-light companies to install, side by side, equipment for lighting one community. This does not, of course, mean that the threat of competition, as of government ownership through the TVA, may not be effective in enforcing a reduction in utility rates.

To extend the analysis to wholesaling or to retailing does not always lead to similar conclusions.

The claim that there are too many wholesalers and too many retailers is as yet without the support of adequate statistical evidence. It may be that the presence in a community of 10 drugstores leads to less efficient drug merchandising and higher prices than would be experienced if there were in that community only 8 drugstores. With 10 drugstores it might be argued that each store is forced to operate at a sales level which is less than its most efficient operating level. If the number of stores were reduced from 8 to 6 or even to 4, thereby substantially diminishing competition, would the argument continue in the same vein? At what sales volume does a druggist obtain an optimum point of operating efficiency? Proposals to limit by legal means the right to enter any type of business must answer such questions as these. Exact demonstration of the point at which competition becomes too severe and begins to exert a lifting effect upon marketing costs has not yet been satisfactorily presented.

Relative Cost of Direct and Indirect Marketing.—Another type of proposal for reducing marketing costs centers around the argument that direct-marketing methods are more efficient and less expensive than indirect-marketing methods.[1] The student who realizes that the same functions must be performed in the marketing of products, regardless of what agencies perform them, is brought face to face with the realities of this proposal. It cannot be demonstrated that direct marketing under all conditions is less expensive than indirect marketing. In fact, there seems to be ample proof to the contrary. The very fact that many business enterprises which are wisely administered

[1] This question is discussed in J. F. Thomas, Varying Functions in Distribution, Their Costs and Influence on Retail Prices, *The Journal of Marketing*, July, 1938, p. 47.

continue to use indirect-marketing methods is a good indication that direct-marketing methods are not always more efficient.

Does Cooperative Marketing Reduce Costs?—Proposals for reducing the costs of marketing which involve the increased use of cooperative methods must come to grips with the same question.[1] The mere act of cooperation does not guarantee lower marketing costs. Cooperation must perform the vital marketing functions more efficiently and must share the benefits of the increased efficiency with consumers. Results of this type are not and cannot be secured by all cooperatives.

Conclusions.—Reductions in marketing costs may be expected to be secured slowly. To a large extent they must result from more careful study of marketing techniques. The contributions of marketing should be measured, not in terms of the cost of marketing alone, but more directly in terms of ultimate prices. In industry after industry the reductions in factory costs, which have been hailed as triumphs of engineering and management techniques, can be traced in large part to the extension and development of markets. Increased marketing costs may be evidence of greater, not less, efficiency in distribution, when they make possible even greater decreases in production costs. The ultimate price to consumers, which determines real incomes, is the final arbiter of business efficiency.

[1] Palmer, J. L., Can Consumer Cooperation Correct Important Defects in Marketing, *The Journal of Marketing*, April, 1937, p. 390.

CHAPTER XVIII

MARKETING: LAWS AND MEN

"As consumers, the public's interest in business is fundamentally the same whether the functions of business involve production or distribution of merchandise or the rendition of services. While, on the one hand, the interest of the public is the desire to obtain merchandise and services of known quality at the lowest possible prices, there exists, on the other hand, the national interest and objective of the same public to improve living standards, to expand consumption, to increase employment, and to insure a degree of stability to all forms of business —all to the end that the public welfare may be promoted and prosperity attained. These two interests, arising from the same body of citizens, are by no means irreconcilable.

"When business enterprise is successfully carried on with constant and efficient endeavor to reduce costs of production and distribution, to improve the quality of its products, and to give fair treatment to customers, employees, management, and capital, it renders public service of the highest order. The gains resulting from such business activity inevitably benefit the consuming public and add to the national welfare.

"Business enterprises engaged in distribution have the responsibility of passing on to the consumer the benefits which the ingenuity and efficient equipment of producers have made possible. Distributive enterprises have further responsibilities, not only to conduct their own activities in such a manner that the benefits accruing from efficient methods of production may be preserved, but they must constantly meet the challenge of improving their services while lowering their operating costs. A second-rate performance on the part of distribution inevitably results in imposing upon the consumer unnecessary costs which not only rob him of the benefits resulting from manufacturers' economies, but through curtailment of buying power, hamper his ability to buy the manufacturers' most attractive developments. To the extent that efficiencies in distribution can be realized there are opened up increased opportunities for manufacturers to expand their output and to develop new lines and values with consequent advantages to the public."[1]

The Problem of Modern Marketing.—Probably no more acute criticism of business has ever been made than that which

[1] "Fair Competition in Distribution," U.S. Chamber of Commerce, March, 1936.

charges it with uninformed, uncoordinated administrative policies. There are grounds for believing that the present generation of businessmen is approaching a realization of the importance and the justice of this line of criticism. Particularly in marketing, the failure to adapt the principles of scientific management to the solution of business problems has been a major contributor to high cost and inefficient distribution.

This is not a problem of social interest alone. Consumers and businessmen find a joint bond here in increasing the flow of goods and services and in accomplishing that end with continually falling costs. In entering upon an analysis of this basic problem a necessary first step is the study of marketing practice. The second step is building a broad understanding of the reasons for the present organization of marketing practice. The third step is the attempt to phrase general marketing problems in terms of controlling factors. These factors may be summarized as those of legal origin and those of human origin, as those factors which arise because of legal framework and those which arise because of human abilities and disabilities.

By way of preface, it may be helpful to examine the general character of recent changes in the marketing structure. A number of these changes have already been pointed out in the course of the present volume. Perhaps basic to all change has been the recognition of the importance of the consumer as a directing force in the marketing process. This change appears to indicate the desirability of establishing as a basic rule for all merchandising policy the satisfaction of consumer wants. Increasingly, merchandising policy directs its attention to consumer analysis. A realization that efficient marketing is necessarily marketing in reverse, *i.e.*, marketing which starts with the consumer and works back to the manufacturer, may be said to be an outstanding influence affecting recent changes in distribution.

Another change of importance is the growing recognition of the desirability of fact finding in distribution. This is closely aligned to the investigation of consumer buying habits. It is united also to the general problem of cost accounting and the possibilities of turning the business searchlight of cost-accounting techniques upon marketing, as it has been directed in the past upon production. If modern marketing does no more than

utilize these two relatively new tools of investigation, consumer analysis and cost accounting, it may be expected to produce great improvements in the supply of goods and services and in increasing the real incomes of the inhabitants of this country. These two changes may be regarded as fundamental shifts in marketing now in process of evolution.

There are other, perhaps indirect, developments which are exerting an important influence upon modern marketing. Among them are those shifts in organization and in types of institutions in both wholesaling and retailing which have been pointed out in previous chapters. They may be summarized briefly here. In wholesaling, there has been a tendency for increased specialization, for the division of wholesaling establishments into full-service and limited-service organizations, and for specialization within these groups by all the gradations from full service to nonservice. There has been further specialization by lines of merchandise and by geographic coverage. The position of the wholesaler has been weakened by changes in distributive practice which may be briefly described as the tendency for producers to extend their control forward toward the retailers and for retailers to extend their control back toward the producers. Wholesalers have been caught between these two developments, and to some extent their position has been endangered. Present evidence is inconclusive for supporting the belief that the wholesaler will continue to decline in importance. Many commentators have reached the conclusion that the wholesaler's position will not be seriously endangered until he is unable to perform his functions as efficiently as they can be performed by substitute institutions.

In the field of retailing, the developments of recent years have not presented quite so clear a picture. The basic tendency toward specialization has continued, as has that of mass organization by chain-distributive agencies. At the same time, there is a tendency away from specialization in the direction of what has been called "scrambled merchandising." Opposition to the chain-store development has been widespread, vocal, and at least temporarily effective. Chain-store techniques have been adapted to the administration of independent retail business. There is reason to believe that the inroads made by chain organizations upon independent business, resulting largely from the

ineffective competition of independent business, may not continue at the same rate in the future.

Among other changes of importance some attention should be devoted to developments in the field of price policy. An increasing rigidity in the price structure must be regarded as a factor of great importance. By law, tradition, and trade practice, prices are hampered in their full movement up and down. The implications of this situation affect not only local price adjustments, but the business cycle itself. By setting up artificial barriers to the natural flow of distribution, rigid prices serve as detriments to marketing on a level of high efficiency.

Implications of Changes in Marketing Institutions.—Specific developments can be traced from most of the recent changes in marketing. New types of wholesale firms have developed to positions of importance. Limited-service wholesalers, wagon jobbers, and limited-area wholesalers have entered as links in distribution. New types of retail institutions have developed. The supermarket is an outstanding example. A comprehensive list should also include the growth of the modern drugstore into a miniature department store, the changes in structure which have affected the urban department store, the development of the specialty shop, and the rise of the voluntary chain.

General changes in distribution policies of manufacturers may also be traced to the broad changes in marketing institutions. Decisions to sell direct in some areas and through wholesalers in others, decisions involving the use of exclusive- as against mass-distribution methods, and decisions revolving around the proportion of total advertising expenditures to be borne by the manufacturer all date from important recent changes in marketing structure. Marketing appears to be in an evolutionary stage corresponding to the stage of production toward the third quarter of the last century.

Legal Framework of Marketing.—At the present time a great deal of confusion exists with respect to the influence of laws upon marketing practice. The confusion extends into every phase of distribution. It is clearly the result of the failure to reconcile the conflicting statements which have been made about the policies, the aims, the purposes, and the ends of distribution. Within the field of this confusion arise the conflicting forces of pressure groups, some attempting to increase competition by legislative

action, others attempting, again by legislative action, to lessen competition in favor of monopoly. Within this field also arise conflicts between those who advocate freedom of price movements, those who favor taxation for revenue purposes, and those who favor punitive or regulatory taxation. Above all, confusion arises when price-interest groups offer legislation under disguise.

It is difficult to evade the conclusion that a chaotic and unpredictable marketing structure will continue to exist until some clarification of the legal framework of marketing is achieved. So long as some laws are framed with the purpose of protecting and increasing competition, while others have contrary ends in view, the marketing structure cannot be organized rationally. This clarification may not be brought about in the very near future. The one force which is in a position to devote itself clearly to the work of solution is that exerted by the individual as consumer and as voter.

A number of specific examples may be cited as descriptive of situations within the legal framework of marketing which need clarifying. One is the general problem of taxation as it affects chain organizations and supermarkets. It is necessary to determine whether society as a whole wants such taxation to be for revenue purposes only, or to be designed as regulatory and punitive decisions for the control of limited types of business institutions. At the present time the trend of such tax legislation is clearly in the direction of the punitive ideal. Many major problems are connected with this question. Consumers may have to pay higher prices; the operators of chain stores and supermarkets may secure lower profits; the owners of independent stores may secure lessened competition and may hope for higher profits.

A second important problem centers around the general question of price maintenance. Here, too, a considerable degree of confusion clouds the issue. Do we want price maintenance in the interest of consumers, in the interest of retailers, in the interest of wholesalers, or in the interest of manufacturers? The basic question of whether price maintenance itself is desirable in any form has not been settled, not, at least, to the satisfaction of consumers and certainly not to the satisfaction of manufacturers.

Certain other types of legislation affecting marketing seem, upon first study, to be representative of a somewhat clearer line of thought. They seem to be aimed, that is, at the general line of increasing competition as it has been traditionally interpreted. They have also consistently held to the purpose of protecting consumers against unfair or deceptive business practices. The legislation may be attacked piecemeal. It is faulty, perhaps hastily conceived. Its consistency, however, is a satisfactory feature. One may include in this group such legislation as the Robinson-Patman Act, the Wheeler-Lea Act, and legislation governing operations on commodity exchanges. Legislation designed to protect consumers against what may be generally termed unfair or deceptive business practices is difficult to debate. On many grounds support may be found for the Robinson-Patman Act in theory, if not in practice. The difficulties which arise are not insuperable, inasmuch as they are difficulties of administration and enforcement, not difficulties arising from major confusion of thought.

It should be maintained clearly in mind that laws are not written in the abstract. Under modern political conditions they are framed by pressure groups, supported by bloc action and designed to achieve specific ends. It should be maintained clearly in mind that they may affect, not only specialized marketing institutions, but the general costs of distribution and so consumers.

Human Control in Marketing.—Human control in marketing must operate within the framework of the laws which society has erected. Perhaps it may be added, human control must also operate within the traditions society has accepted. To some extent the traditions may be modified; the laws, save for the slight elasticity of interpretation, form a rigid framework, continuing until the legislation is repealed. Within such limitations what can human control accomplish to make marketing more efficient, more serviceable, less costly, more productive?

Indications have been given in previous chapters of the directions in which human control may work. Marketing has suffered while production has gained, solely because production has received the major part of executive attention. Doubtless this was a natural result of the Industrial Revolution which drew attention forcefully to productive possibilities.

That condition which first caused marketing to suffer is no longer acute. The time is ripe for extended study of the problems of marketing, and this study may profitably be directed toward the elements of human control of marketing as sources of possible correction and reform.

Human control in marketing may be expected to work, therefore, toward a more rational understanding and control of the marketing process. It may use as tools of analysis and control the techniques of management, of cost accounting, and of marketing research. It may work toward a more complete comprehension of the general problem of competition and monopoly. Above all, it must be grounded on an understanding of the role of the consumer as the beginning of the marketing process.

APPENDIX A

Expenditure Patterns of Chicago, Native White, Nonrelief Families, by Income Groups, 1935–1936
(Per Cent of Total Money Expenditures in Each Group)

Family income group[a]	Families reporting expenditures[b]	Food	Clothing	Housing[c]	Household operation[d]	Furnishing, equipment	Automobile purchase and operation	Other transportation	Personal and medical care	Recreation	Tobacco	Reading	Education	Gifts and direct taxes	Other items of expense
$ 500–$ 750	50	42.0	5.5	34.6	3.1	0.7	0.6	2.5	5.1	1.4	2.0	1.1	0.2	1.2	(e)
750– 1,000	110	39.8	7.3	32.0	2.9	1.7	0.8	3.0	6.5	1.4	2.1	1.2	0.2	1.0	0.1
1,000– 1,250	139	39.2	8.0	28.8	3.2	2.6	3.0	2.6	6.0	1.8	2.0	1.1	0.2	1.4	0.2
1,250– 1,500	238	39.1	8.1	27.1	3.5	2.2	2.6	2.9	6.4	2.2	2.2	1.3	0.4	1.8	0.2
1,500– 1,750	217	36.7	8.5	26.6	3.5	2.4	4.1	2.4	7.0	2.2	2.4	1.1	0.5	2.0	0.6
1,750– 2,000	264	31.5	9.1	25.8	3.8	3.2	5.4	2.4	6.4	2.6	2.1	1.1	0.6	2.4	0.6
2,000– 2,250	256	33.2	9.7	24.2	4.2	3.2	6.7	2.2	6.7	2.8	2.0	1.1	0.8	2.8	0.4
2,250– 2,500	269	34.2	9.5	23.3	4.7	3.1	5.3	2.3	7.2	3.1	2.1	1.1	0.8	2.8	0.5
2,500– 3,000	295	31.7	10.6	22.4	5.0	3.1	6.8	2.4	6.9	3.3	2.1	1.0	0.9	3.3	0.5
3,000– 3,500	226	31.5	10.5	19.9	5.6	2.9	7.1	2.3	6.9	4.0	2.2	1.0	1.0	4.6	0.5
3,500– 4,000	206	30.1	11.8	20.7	5.7	3.7	7.4	1.9	6.8	3.3	2.1	1.0	1.0	4.2	0.3
4,000– 5,000	197	28.3	11.7	18.3	6.9	2.6	8.6	2.0	7.3	3.7	1.9	1.0	1.0	6.5	0.2
5,000– 7,500	102	24.3	11.1	18.2	8.8	2.6	9.6	1.4	7.1	4.7	1.7	0.9	1.6	7.5	0.5
7,500– 10,000	37	21.6	12.5	18.1	9.9	2.6	9.9	1.2	6.2	4.6	1.6	1.0	1.8	8.3	0.7
10,000 and over	29	17.2	12.5	16.1	9.2	2.8	7.1	2.6	3.8	4.1	1.2	0.8	3.4	18.6	0.6

[a] Income includes the imputed income of homeowners, *i.e.*, the excess of rental value over total money expense.

[b] Selected so as to give adequate representation to families of each occupation and size, but does not indicate the relative frequency at an income level. Averages for an income level take into account the frequency of each occupation and size at that income level, as determined from a 10% random sample of Chicago's native white families.

[c] Includes rent and money expense of homeowners for taxes, interest on mortgages and other items, and also fuel, light, and refrigeration.

[d] Excludes fuel, light, and refrigeration.

[e] Percentage less than 0.05.

Source: Based upon Urban Study of Consumer Purchases, U.S. Bureau of Labor Statistics, Report Containing Tabular Summary of Current Expenses, Surplus and Deficit According to Family Income in 32 Cities, June 15, 1938. Released July 10, 1938.

APPENDIX B

FAMILY BUDGETS FOR AN EXECUTIVE, A CLERK, AND A WAGE EARNER, LIVING IN SAN FRANCISCO, CALIFORNIA

Item	Executive[a]		Clerk[b]		Wage earner[c]	
	Dollars	Per cent	Dollars	Per cent	Dollars	Per cent
Total cost	$5,590.88	100.00	$2,033.41	100.00	$1,544.16	100.00
Income tax	49.86	0.9				
Food	835 24	15.0	599.43	29.5	496.76	32.2
Meals at home	682.24	12 2	491.43	24.2	496.76	32.2
Husband's lunches	153.00	2.8	108.00	5.3		
Clothing and upkeep	705 94	12.6	360.24	17.7	226 56	14.7
Replacement	674.21	12.0	346.17	17 0	216.42	14.0
Upkeep	31.73	0.6	14 07	0.7	10.14	0.7
Shelter	1,741.16	31.1	568.26	27.9	449.68	29.1
Housing	929.51	16.6	330.00	16.2	270.00	17.5
House operation	569 82	10.2	154.56	7.6	123.90	8.0
Light and fuel	180.88	3.2	88.84	4.4	78 40	5.1
Service	217.88	3.9				
Other	171.06	3.1	65.72	3.2	45.50	2.9
Furnishings	241 83	4.3	83.70	4.1	55.78	3.6
Miscellaneous	2,258 68	40.4	505 48	24.9	371.16	24.0
Care of the person	89.35	1.6	47 15	2.3	39.27	2.5
Leisure-time activities	487.41	8.7	170.20	8.4	123.76	8.0
Automobile upkeep	444.79	7.9				
Carfare	40.00	0.7	60.00	3.0	45.00	2.9
Investments	620 00	11.1				
Medical care	275.00	4.9	75.00	3.7	75.00	4 9
Life insurance	[d]		130.00	6.4	65.00	4.2
Association dues	36.00	0.6				
Education	101.13	1.8	5.13	0.2	5.13	0.3
Church and charity	105.00	1.9	18.00	0.9	18.00	1.2
Incidentals	60.00	1.1				

[a] Man, wife, boy of eleven, girl of five.
[b] Man, wife, boy of eleven, girl of five, boy of two.
[c] Man, wife, boy of eleven, girl of five, boy of two.
[d] Life insurance provided for under investments.

SOURCE: Heller Committee for Research in Social Economics, Quantity and Cost Budget, 1935.

APPENDIX C

OCCUPATIONS OF GAINFUL WORKERS, 10 YEARS OLD AND OVER FOR THE UNITED STATES
(000 Omitted)

Occupation	1930		1920		1910	
	Number	Per cent	Number	Per cent	Number	Per cent
Total	48,830	100.0	41,614	100.0	38,167	100.0
1. Agriculture	10,472	21.4	10,666	25.7	12,388	32.5
2. Forestry and fishing	251	0.5	270	0.6	242	0.6
3. Extraction of minerals	984	2.0	1,090	2.6	965	2.5
4. Manufacturing and mechanical industries	14,111	28.9	12,832	30.8	10,657	27.9
5. Transportation and communication	3,848	7.9	3,097	7.5	2,665	7.0
6. Trade	6,082	12.5	4,258	10.2	3,633	9.5
7. Public service	856	1.8	738	1.8	432	1.1
8. Professional service	3,254	6.7	2,171	5.2	1,711	4.5
9. Domestic and personal service	4,952	10.1	3,380	8.1	3,756	9.9
10. Clerical occupations	4,025	8.2	3,112	7.5	1,718	4.5

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of Occupation, 1930.

APPENDIX D

Distribution of Aggregate Incomes Received, by Income Levels, 1935–1936

Income level	Families and single individuals: Number	Per cent at each level	Cumulative per cent	Aggregate income: Amount (000 omitted)	Per cent at each level	Cumulative per cent
Under $ 250	2,123,534	5.38	5.38	$ 294,138	0.50	0.50
$ 250–$ 500	4,587,377	11.63	17.01	1,767,363	2.98	3.48
$ 500–$ 750	5,771,960	14.63	31.64	3,615,653	6.10	9.58
$ 750–$ 1,000	5,876,078	14.90	46.54	5,129,506	8.65	18.23
$ 1,000–$ 1,250	4,990,995	12.65	59.19	5,589,111	9.42	27.65
$ 1,250–$ 1,500	3,743,428	9.49	68.68	5,109,112	8.62	36.27
$ 1,500–$ 1,750	2,889,904	7.32	76.00	4,660,793	7.87	44.14
$ 1,750–$ 2,000	2,296,022	5.82	81.82	4,214,203	7.11	51.25
$ 2,000–$ 2,250	1,704,535	4.32	86 14	3,602,861	6.08	57.33
$ 2,250–$ 2,500	1,254,076	3.18	89.32	2,968,932	5.01	62.34
$ 2,500–$ 3,000	1,475,474	3.74	93.06	4,004,774	6.76	69.10
$ 3,000–$ 3,500	851,919	2.16	95.22	2,735,487	4.62	73.72
$ 3,500–$ 4,000	502,159	1.27	96.49	1,863,384	3.14	76.86
$ 4,000–$ 4,500	286,053	0.72	97.21	1,202,826	2.03	78.89
$ 4,500–$ 5,000	178,138	0.45	97.66	841,766	1.42	80.31
$ 5,000–$ 7,500	380,266	0.96	98.62	2,244,406	3.79	84.10
$ 7,500–$ 10,000	215,642	0.55	99.17	1,847,820	3.12	87.22
$ 10,000–$ 15,000	152,682	0.39	99.56	1,746,925	2.95	90.17
$ 15,000–$ 20,000	67,923	0.17	99.73	1,174,574	1.98	92.15
$ 20,000–$ 25,000	39,825	0.10	99.83	889,114	1.50	93.65
$ 25,000–$ 30,000	25,583	0.06	99.89	720,268	1.22	94.87
$ 30,000–$ 40,000	17,959	0.05	99.94	641,272	1.08	95.95
$ 40,000–$ 50,000	8,340	0.02	99.96	390,311	0.66	96.61
$ 50,000–$ 100,000	13,041	0.03	99.99	908,485	1.53	98.14
$ 100,000–$ 250,000	4,144	0.01	100.00	539,006	0.91	99.05
$ 250,000–$ 500,000	916	[a]	......	264,498	0.45	99.50
$ 500,000–$1,000,000	240	[a]	......	134,803	0.23	99.73
$1,000,000 and over	87	[a]	......	157,237	0.27	100.00
All levels	39,458,300	100.00	......	59,258,628	100.00	

[a] Less than 0.005 per cent.

Source: "Consumer Incomes in the United States," p. 6, National Resources Committee, August, 1938.

APPENDIX E

DISTRIBUTION EXPENSES OF MANUFACTURERS, BY INDUSTRIES: 1935
(Net Sales = 100 Per cent)

Name of Industry	Distribution Expense, Per Cent
Food and kindred products:	
Beverages, nonalcoholic	22.9
Bakery products other than biscuit and crackers	20.8
Biscuit and crackers	17.0
Butter	6.9
Canned and dried fruits and vegetables; preserves, jellies, fruit butters, pickles, and sauces	12.0
Canned and preserved fish, crabs, shrimps, oysters, and clams	7.8
Cereal preparations	13.7
Cheese	10.2
Chewing gum	23.8
Chocolate and cocoa products, not including confectionery	7.2
Condensed and evaporated milk	9.6
Confectionery	12.2
Corn sirup, corn sugar, corn oil, and starch	7.9
Feeds, prepared, for animals and fowls	7.2
Flavoring extracts and flavoring sirups	23.2
Flour and other grain-mill products	5.0
Food preparations not elsewhere classified	18.0
Ice cream	22.8
Ice, manufactured	25.3
Liquors, distilled	8.3
Liquors, malt	13.9
Liquors, rectified and blended	12.0
Liquors, vinous	20.6
Macaroni, spaghetti, vermicelli, and noodles	13.1
Malt	4.3
Meat packing, wholesale	4.4
Oleomargarine (margarine) not made in meat-packing establishments	11.0
Poultry killing, dressing, and packing, wholesale	6.8
Rice cleaning and polishing	6.6
Sausage, meat puddings, headcheese, etc., and sausage casings	11.6

Name of Industry	Distribution Expense, Per Cent
Shortenings (other than lard), vegetable cooking oils, and salad oils	3.8
Sugar, beet	9.5
Sugar, cane, not including products of refineries	4.7
Sugar refining, cane	1.6
Vinegar and cider	9.6
Textiles and their products:	
Carpets and rugs:	
Paper, fiber, and grass carpets and rugs	21.9
Rag carpets and rugs	22.5
Wool carpets and rugs (other than rag)	8.3
Woolen and worsted carpet yarn	1.8
Cordage and twine; jute goods, linen goods:	
Cordage and twine	8.3
Jute goods	4.0
Linen goods	23.3
Cotton manufactures:	
Cotton woven goods (over 12 in. in width) and cotton felts	4.9
Cotton narrow fabrics	8.6
Cotton yarn and thread	6.4
Fish nets and seines	9.9
Dyeing and finishing cotton, rayon, and silk:	
Yarn dyeing and finishing	4.0
Cotton fabric dyeing and finishing	4.5
Rayon and silk fabric dyeing and finishing	7.5
Felt goods, except woven felts	7.8
Hats, except cloth hats and millinery:	
Fur-felt hats	10.6
Wool-felt hats	9.1
Straw hats, men's	11.6
Hat and cap materials, men's	7.4
Knit goods:	
Hosiery	8.9
Knitted cloth	4.9
Knitted outerwear	12.0
Knitted underwear	9.4
Lace goods	12.4
Rayon manufactures:	
Rayon broad woven goods (18 in. wide and over)	5.5
Rayon narrow fabrics	12.3
Rayon yarn and thread	6.2
Silk manufactures:	
Silk broad woven goods (18 in. wide and over)	8.1
Silk narrow fabrics	11.7
Silk yarn and thread	10.3

Name of Industry	Distribution Expense, Per Cent
Waste and related products:	
Batting, padding, and wadding; upholstery filling	6.5
Processed waste and recovered wool fiber	10.4
Wool and hair manufactures:	
Wool combing—commission, and tops for sale	2.7
Woolen yarn	4.8
Worsted woven goods	2.2
Worsted yarn	4.1
Woolen and worsted dyeing and finishing	19.8
Haircloth	3.6
Men's cotton garments:	
Collars	[a]
Shirts and nightwear	11.1
Work clothing	9.3
Men's furnishing goods:	
Underwear	10.7
Furnishing goods not elsewhere classified	15.2
Hats and caps, except felt and straw	18.4
Men's, youths', and boys' clothing	9.4
Women's and children's apparel:	
Blouses	15.5
Children's wear (outerwear)	10.6
Coats and suits (including separate skirts)	8.6
Corsets and allied garments	17.6
Dresses	9.5
Infants' wear	10.7
Millinery	14.6
Underwear and nightwear	8.1
Women's, misses', and children's clothing, not elsewhere classified	12.5
Miscellaneous apparel and related industries:	
Gloves and mittens, cloth or cloth and leather combined	7.8
Handkerchiefs	7.2
Suspenders, garters, and other elastic woven goods	15.2
House furnishings:	
Curtains, draperies, and bedspreads	10.6
House furnishings not elsewhere classified, including sheets and towels	12.3
Other fabricated products:	
Canvas goods	18.9
Bags, other than paper, not made in textile mills	4.0
Flags, banners, regalia, vestments, robes, and related products	24.7
Fabricated products (not elsewhere classified)	15.3

[a] Omitted to avoid disclosures of individual operations.

Name of Industry	Distribution Expense, Per Cent
Artificial leather; oilcloth	11.2
Embroideries; trimmings (not made in textile mills); stamped art goods:	
Embroideries	14.3
Trimmings (not made in textile mills); stamped art goods	15.0
Asphalted-felt-base floor covering: linoleum	5.4
Forest products:	
Baskets and rattan and willow ware, not including furniture	12.4
Billiard and pool tables, bowling alleys, and accessories	12.7
Boxes, cigar, wooden and part wooden	13.8
Boxes, wooden, except cigar boxes	10.6
Caskets, coffins, burial cases, and other morticians' goods	17.9
Cooperage	8.2
Cork products	11.4
Excelsior	7.3
Furniture, including store and office fixtures	13.3
Lasts and related products	14.0
Lumber and timber products not elsewhere classified	8.1
Matches	15.2
Mirror and picture frames	19.9
Planing-mill products	13.0
Plastic and phenolic-resin products and pulp goods	8.3
Turpentine and rosin	11.7
Window and door screens and weather strip	16.7
Wood preserving	9.4
Wood turned and shaped and other wooden goods, not elsewhere classified	11.5
Paper and allied products:	
Bags, paper, exclusive of those made in paper mills	12.3
Boxes, paper, not elsewhere classified	9.5
Cardboard, not made in paper mills	9.4
Card cutting and designing	12.0
Envelopes	12.4
Paper	6.6
Paper goods not elsewhere classified	11.3
Pulp (wood and other fiber)	2.7
Wallpaper	11.2
Printing and publishing:	
Book publishing with and without printing	8.8
Chemicals and allied products:	
Ammunition and related products	12.9
Baking powder, yeast, and other leavening compounds	22.0

Name of Industry	Distribution Expense, Per Cent
Blacking, stains, and dressings	24.5
Bluing	29.7
Bone black, carbon black, and lampblack	7.8
Candles	24.7
Chemicals not elsewhere classified	8.8
Cleaning and polishing preparations	30.1
Compressed and liquefied gases	15.2
Druggists' preparations and patent medicines	21.7
Drug grinding	1.8
Explosives	12.2
Fertilizers	12.1
Fireworks	8.1
Glue and gelatin	16.1
Grease and tallow, not including lubricating greases	10.5
Industrial and household chemicals	24.3
Ink, printing	20.1
Ink, writing	20.5
Mucilage, paste, and other adhesives, except glue and rubber cement	20.2
Oil, cake, and meal, cottonseed	4.3
Oil, cake, and meal, linseed	4.1
Oils, essential	9.5
Oils not elsewhere classified	7.4
Paints, pigments, and varnishes	17.6
Perfumes, cosmetics, and other toilet preparations	27.5
Rayon and allied products	4.7
Salt	26.0
Soap	19.6
Tanning materials, natural dyestuffs, mordants, and sizes	14.8
Wood distillation and charcoal manufacture	6.9
Products of petroleum and coal:	
Coke-oven products	4.8
Fuel briquettes	18.7
Lubricating greases, not made in petroleum refineries	19.9
Petroleum refining	6.8
Rubber products:	
Boots and shoes, rubber	6.3
Rubber goods other than tires, inner tubes, and boots and shoes	10.8
Rubber tires and inner tubes	7.2
Leather and its manufactures:	
Belting and packing, leather	16.8
Boot and shoe cut stock and findings	8.9
Boots and shoes, other than rubber	8.2

Name of Industry	Distribution Expense, Per Cent
Gloves and mittens, leather	9.7
Leather goods not elsewhere classified	14.3
Leather: tanned, curried, and finished	6.9
Pocketbooks, purses, and cardcases	12.6
Saddlery, harness and whips	14.6
Trunks, suitcases, and bags	16.5
Stone, clay, and glass products:	
Abrasive wheels, stones, paper, and cloth, and related products	8.4
Asbestos products, other than steam packing	16.4
Cement	12.6
China firing and decorating, not done in potteries	16.3
Clay products (other than pottery) and nonclay refractories	14.3
Concrete products	15.9
Glass	7.0
Graphite, ground and refined	14.7
Gypsum products	18.0
Lime	10.6
Marble, granite, slate, and other stone, cut and shaped	20.2
Minerals and earths, ground or otherwise treated	15.4
Mirrors and other glass products made of purchased glass	14.3
Pottery, including porcelain ware and nonclay refractories	8.6
Sand-lime brick	11.0
Statuary and art goods (except concrete), factory production	19.1
Wallboard and plaster (except gypsum)	21.0
Iron and steel and their products:	
Blast-furnace products	1.5
Bolts, nuts, washers, and rivets	8.9
Cast-iron pipe and fittings	7.6
Cutlery (not including silver and plated cutlery) and edge tools	19.9
Doors, shutters, and window sash and frames, molding, and trim, metal	15.9
Files	13.6
Firearms	9.3
Forgings, iron and steel	7.7
Hardware, not elsewhere classified	11.7
Nails, spikes, etc	11.2
Plumbers' supplies	11.5
Safes and vaults	29.5
Saws	17.0
Screw-machine products and wood screws	8.4

Name of Industry	Distribution Expense, Per Cent
Springs, steel, except wire	6.9
Stamped and pressed metal products	9.7
Steam and hot-water heating apparatus and steam fittings	14.7
Steel barrels, kegs, and drums	7.1
Steelworks and rolling-mill products	4.4
Stoves and ranges (other than electric) and warm-air furnaces	15.2
Structural and ornamental metalwork	11.3
Tin cans and other tinware not elsewhere classified	4.3
Tools, not including edge tools, machine tools, files, or saws	12.0
Wire drawn from purchased rods	7.2
Wirework not elsewhere classified	9.4
Wrought pipe, welded and heavy riveted	5.8
Nonferrous metals and their products:	
Aluminum products	7.4
Clocks, watches, time-recording devices, materials and parts	9.7
Collapsible tubes	3.4
Fire extinguishers, chemical	23.0
Gold leaf and foil	14.5
Gold, silver, and platinum, refining and alloying	3.5
Jewelers' findings and materials	5.0
Jewelry	16.2
Lighting equipment	12.7
Needles, pins, hooks and eyes, and snap fasterners	9.4
Nonferrous-metal alloys; nonferrous-metal products, except aluminum	6.8
Sheet-metal work not specifically classified	15.7
Silverware and plated ware	14.4
Smelting and refining, copper	0.9
Smelting and refining, lead	8.3
Smelting and refining, nonferrous metals other than precious	3.7
Smelting and refining, zinc	4.0
Tin and other foils, not including gold foil	3.5
Watchcases	7.9
Machinery (not including transportation equipment):	
Agricultural implements	6.6
Boiler shops	12.5
Cash registers and other business machines except typewriters	25.8
Cranes; dredging, excavating, and road-building machinery	12.2
Electrical machinery, apparatus, and supplies	10.6

Name of Industry	Distribution Expense, Per Cent
Elevators and elevator equipment	14.7
Engines, turbines, water wheels, and windmills	9.2
Food slicers, choppers, grinders, etc., and related devices	20.4
Foundries	7.9
Machinery, not elsewhere classified	14.9
Machine shops	10.9
Machine-tool accessories and machinists' precision tools	14.1
Machine tools	11.8
Printers' machinery and equipment	16.4
Pumps (hand and power) and pumping equipment	17.4
Radio apparatus and phonographs	12.5
Refrigerators and refrigerating and ice-making apparatus	11.0
Scales and balances	27.0
Sewing machines and attachments	8.4
Textile machinery and parts	11.7
Typewriters and parts	23.9
Washing machines, wringers, driers, and ironing machines	10.6
Transportation equipment, air, land, and water:	
Aircraft and parts	6.5
Carriages and sleds, children's	8.8
Carriages, wagons, sleighs, and sleds	7.4
Motorcycles, bicycles, and parts	7.9
Motor-vehicle bodies and motor-vehicle parts	3.1
Motor-vehicles, not including motorcycles	3.4
Miscellaneous industries:	
Artificial and preserved flowers and plants	17.1
Artists' materials	20.0
Beauty-shop equipment	24.5
Brooms	12.2
Brushes, other than rubber	17.9
Buttons	11.0
Carbon paper and inked ribbons	17.5
Cigarettes	7.9
Cigars	12.1
Combs and hairpins, not made of metal or of rubber	2.7
Dentists' equipment and supplies	17.5
Feathers, plumes and manufactures thereof	18.2
Foundry supplies	16.9
Fur goods	12.6
Furs, dressed and dyed	9.3
Hair work	17.5

Name of Industry	Distribution Expense, Per Cent
Hand stamps and stencils and brands	20.1
Instruments, professional and scientific	14.5
Jewelry and instrument cases	13.5
Lapidary work	11.6
Mattresses and bed springs not elsewhere classified	13.1
Miscellaneous articles not elsewhere classified	17.0
Models and patterns, not including paper patterns	20.1
Musical-instrument parts and materials: piano and organ	10.8
Musical instruments, parts and materials, not elsewhere classified	17.3
Musical instruments: organs	17.7
Musical instruments: pianos	19.0
Optical goods	13.6
Paving materials: blocks (except brick and stone) and mixtures	17.4
Pencils, lead (including mechanical), and crayons	20.2
Pens, fountain and stylographic; pen points	24.8
Pipes (tobacco)	13.2
Roofing, built-up and roll; asphalt shingles; roof coatings	13.9
Signs and advertising novelties	21.1
Soda fountains and accessories	18.1
Sporting and athletic goods, not including firearms and ammunition	13.2
Steam and other packing, pipe and boiler covering and gaskets	14.3
Surgical and orthopedic appliances and related products	13.5
Theatrical scenery and stage equipment	21.1
Tobacco: chewing and smoking, and snuff	14.1
Toys, games, and playground equipment	13.7
Umbrellas, parasols, and canes	10.1
Window shades and fixtures	16.9

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Distribution of Manufacturers' Sales, April, 1937. The percentages shown are for those manufacturers who reported total distribution expense, including pay roll and other expense.

CHART 1 - MARKETING

STUDIES NEEDED BY A MANUFACTURER PRIOR TO A CAPITAL INVESTMENT IN THE PRODUCTION AND MARKETING OF A NEW CONSUMER PRODUCT

	Size of Market (Numerical)	Geographical Location of Market	Dollar Value of Market	Purchasing Power of Market	Market Buying Habits (Distributive)	Market Buying Habits (Consumer)	Firm's Relation to Market	Competition	Manufacturer's Price Policy	Distribution Method	Credit and Collection Policy	Sales Promotion	Sales Organization	Cost to Consumer	Service to Consumer	Price Policy to Consumer	Control of Product to Consumer
1. THE MARKET																	
Who will use the new product? (What class of people)	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
What is the geographical location of the market? (Where are they located)	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
What is the income of the potential users of the new product?	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
What areas contain the major part of the market?	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		
What is the growth projection of the market?					✓		✓	✓	✓	✓	✓	✓	✓	✓	✓		
What is the present consumption of comparative products?	✓	✓	✓	✓	✓			✓	✓	✓	✓	✓	✓				
Will the new product go into export fields?	✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	✓	✓	✓		
2. BUYING HABITS OF THE MARKET. (Distributive Group)																	
Who will buy the new product (wholesalers and retailers)	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓				✓	✓
What is the average number of people who must be contacted before the order can be closed?					✓		✓	✓	✓	✓	✓	✓					
What is the average time between first contact and sale?					✓		✓	✓	✓	✓	✓	✓					
What relative weight does the market give to quality, style, service or other qualities of the new product, especially in relation to the merchandise which it will replace?					✓		✓	✓	✓	✓	✓	✓					
At what season is the buying done?		✓			✓		✓	✓	✓	✓	✓	✓					
What are the market practices on discounts; allowances; billing; credit or other financial factors?		✓			✓		✓	✓	✓	✓	✓	✓				✓	✓
What price can you expect the market to pay for the new product on the basis of current prices of comparative goods?	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓				✓	✓
(Ultimate Consumers)																	
Who will buy the new product?		✓				✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
What relative weight does the consumer give to quality, style, service, cost of operation of similar merchandise?		✓				✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Is similar merchandise being sold on time payment?	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
At what season is the buying done?	✓	✓				✓	✓	✓			✓	✓			✓		
What price can the consumer be expected to pay for the new product?	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	
3. FIRM RELATION TO THE MARKET. (Distributive Group)																	
Is the firm name and reputation already established in the market?		✓			✓		✓	✓	✓			✓	✓				
Is the manufacturer's reputation-size-character of merchandise or other quality susceptible to constructive exploitation in establishing the new market?		✓					✓		✓			✓	✓				
(Consumer Group)																	
Is the name and reputation of the manufacturer already established in the consumer's mind in relation to:																	
(A) Similar products?	✓	✓				✓	✓	✓		✓		✓	✓	✓	✓	✓	
(B) Quality?	✓	✓				✓	✓	✓		✓		✓		✓	✓	✓	
(C) Dependability or other virtue?	✓	✓				✓	✓	✓		✓		✓		✓	✓	✓	
Is the firm name or trade mark susceptible to further exploitation among consumers?	✓	✓				✓	✓	✓		✓		✓		✓	✓	✓	
4. COMPETITION																	
What competition will the new product face?		✓			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
What is the standing of competitive manufacturers with the market?					✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Will marketing the new product result in additional or keener competition on the regular line?	✓	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓				
Can any competitor bring out a seriously competitive item quickly?		✓			✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
5. MANUFACTURER'S PRICE POLICY																	
What in general will be the price policy on the new item?	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓		✓	✓	✓	✓	
Who will be entitled to discounts and allowances?																	
What will be the schedule of discounts and allowances to:																	
(A) Exclusive distributors	✓	✓	✓	✓	✓		✓	✓		✓					✓		✓
(B) Wholesalers	✓	✓	✓	✓	✓		✓	✓		✓					✓		✓
(C) Retailers	✓	✓	✓	✓	✓		✓	✓		✓					✓		✓
(D) Other channels	✓	✓	✓	✓	✓		✓	✓		✓					✓		✓
Will base price be the suggested resale or consumer price?					✓	✓	✓	✓		✓				✓			✓
Will net prices be:																	
(A) F.O.B. factory		✓			✓					✓			✓	✓			
(B) Local warehouse		✓			✓					✓			✓	✓			
(C) Delivered		✓			✓					✓			✓	✓	✓	✓	
What will be the credit policy?		✓			✓	✓	✓	✓		✓			✓	✓	✓	✓	
What new credit facilities will be needed?		✓			✓	✓	✓	✓	✓	✓	✓			✓	✓	✓	
What will be the collection policy?		✓			✓	✓	✓	✓			✓				✓	✓	
What will be the policy on:																	
(A) Return of goods?		✓			✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	
(B) Consignment of goods?		✓			✓	✓	✓	✓		✓			✓			✓	✓
(C) Order cancellations?		✓			✓	✓	✓	✓		✓			✓	✓	✓	✓	
(D) Damaged or unsatisfactory goods?		✓			✓	✓	✓	✓		✓			✓	✓	✓	✓	

CHART I-MARKETING
(CONTINUED)

STUDIES NEEDED BY A MANUFACTURER PRIOR TO A CAPITAL INVESTMENT IN THE PRODUCTION AND MARKETING OF A NEW CONSUMER PRODUCT

	SIZE OF MARKET (NUMERICAL)	GEOGRAPHICAL LOCATION OF MARKET	DOLLAR VALUE OF MARKET	PURCHASING POWER OF MARKET	MARKET BUYING HABITS (DISTRIBUTIVE)	MARKET BUYING HABITS (CONSUMER)	FIRM'S RELATION TO MARKET	COMPETITION	MANUFACTURER'S PRICE POLICY	DISTRIBUTION METHOD	CREDIT AND COLLECTION POLICY	SALES PROMOTION	SALES ORGANIZATION	COST TO CONSUMER	SERVICE TO CONSUMER	PRICE POLICY TO CONSUMER	CONTROL OF PRODUCT TO CONSUMER
6. CHANNELS OF DISTRIBUTION																	
WHAT TYPE OF DISTRIBUTION WILL BE USED?																	
(A) FACTORY SALES BRANCES?	✓	✓	✓	✓	✓	✓	✓	✓		✓		✓	✓	✓	✓	✓	✓
(B) EXCLUSIVE DISTRIBUTORS?	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
(C) GENERAL WHOLESALERS?	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
(D) EXCLUSIVE DEALER?	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
(E) FREE DEALER	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
(F) FACTORS-AGENTS-BROKERS?	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
(G) DIRECT TO CONSUMER?	✓	✓				✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	
(H) LARGE DEPARTMENT STORES, MAIL ORDER-CHAINS ONLY?	✓	✓				✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	
(I) ANY COMBINATION OF THESE?	✓	✓				✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	
WHERE WILL SERVICE STOCKS BE MAINTAINED?																	
(A) FACTORY	✓	✓	✓		✓		✓	✓	✓								
(B) BRANCH WAREHOUSES	✓	✓	✓		✓		✓	✓	✓								
(C) SERVICE WAREHOUSES	✓	✓	✓		✓		✓	✓	✓								
(D) DISTRIBUTORS-WHOLESALERS-RETAILERS	✓	✓	✓		✓		✓	✓	✓								
IF THE NEW PRODUCT IS SUBJECT TO EXPORT, WHAT TYPE OF DISTRIBUTION WILL BE USED?					✓		✓	✓	✓		✓	✓	✓				
7. SALES PROMOTION																	
WILL THE NEW PRODUCT HAVE ITS OWN SALES PROMOTION SET UP?	✓	✓	✓	✓	✓		✓	✓		✓		✓	✓	✓	✓		
WILL A NEW ADVERTISING SECTION OR DEPARTMENT BE NEEDED?	✓	✓	✓	✓	✓		✓	✓		✓		✓	✓	✓	✓		
WILL A NEW OR EXTENDED AGENCY CONNECTION BE NEEDED?	✓	✓	✓	✓	✓		✓	✓		✓		✓	✓		✓		
WILL DISTRIBUTORS BE AIDED WITH LOCAL ADVERTISING?	✓	✓	✓		✓	✓	✓	✓	✓	✓		✓		✓			
OTHER SALES PROMOTION AIDS?	✓	✓	✓		✓	✓	✓	✓	✓	✓		✓		✓			
WHAT SALES PROMOTION AIDS WILL BE SUPPLIED TO WHOLESALERS? RETAILERS?		✓	✓		✓		✓	✓				✓	✓	✓			
WILL ADVERTISING AND SALES PROMOTION COSTS BE SHARED BY DISTRIBUTORS?		✓			✓		✓	✓	✓	✓		✓	✓	✓			
WILL THERE BE ORGANIZED PUBLICITY?		✓			✓		✓	✓	✓	✓		✓	✓	✓			
WHAT IN GENERAL ARE THE SALES PRO-PRACTICES OF DISTRIBUTORS																	
FOR RESELLING THE PRODUCT?		✓			✓	✓		✓	✓	✓		✓	✓	✓			
WHAT SALES PROMOTIONAL EFFORT IS BEING MADE BY COMPETITIVE MANUFACTURERS?		✓			✓	✓		✓	✓	✓		✓	✓	✓			
WHAT WILL BE THE BASIS OF THE SALES PROMOTION BUDGET?					✓	✓		✓	✓			✓		✓	✓		✓
8. ORGANIZATION AND MANAGEMENT OF SALES FORCE																	
WILL A SPECIAL SALES STAFF OR DEPARTMENT BE NEEDED FOR THE NEW PRODUCT?	✓	✓			✓	✓	✓	✓		✓			✓	✓	✓		
WILL SALESMEN NEED SPECIAL OR TECHNICAL TRAINING?					✓	✓	✓	✓		✓			✓	✓	✓		
WILL THE ENTIRE SALES FORCE WORK FROM THE HOME OFFICE?	✓	✓			✓	✓	✓	✓		✓			✓				
HOW WILL TERRITORIES AND ROUTING BE HANDLED?	✓	✓	✓	✓	✓	✓	✓	✓		✓							
IF SALES ARE SEASONAL, WILL SALESMEN DO MISSIONARY WORK BETWEEN TIMES?							✓	✓	✓				✓				
WHAT MISSIONARY SELLING WILL BE NEEDED FOR INTRODUCTORY PURPOSES?	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
WHAT SALES PROMOTIONAL AIDS WILL SALESMEN RECEIVE?												✓	✓	✓			
WHAT WILL BE THE BASIS OF SALESMEN'S COMPENSATION?								✓	✓					✓	✓		
9. OTHER FACTORS																	
IS THE NEW PRODUCT PATENTABLE?								✓	✓					✓			
IS ITS TRADE MARK PROTECTED?							✓	✓	✓					✓			
ARE ALL CLAIMS TO ROYALTIES OR OTHER INDEMNITIES SETTLED?									✓					✓			
DO ROYALTIES LIMIT THE MARKET FOR THE PRODUCT?	✓	✓		✓			✓	✓	✓					✓			
DO CODES AND/OR OTHER TRADE AGREEMENTS LIMIT THE MARKET OR SALES EFFORTS?	✓	✓		✓			✓	✓	✓					✓			
HAVE LOCAL TAX AND OTHER CIVIL PROBLEMS BEEN SOLVED?	✓	✓						✓	✓					✓			
HAVE ALL TRANSPORTATION PROBLEMS BEEN CONSIDERED?	✓	✓	✓					✓	✓					✓			

Charts in Appendix F and Appendix G are from the U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce.

APPENDIX G

CHART 1 - MARKETING

STUDIES NEEDED BY A MANUFACTURER PRIOR TO A CAPITAL INVESTMENT IN THE PRODUCTION AND MARKETING OF A NEW INDUSTRIAL PRODUCT

	SIZE OF MARKET	GEOGRAPHICAL LOCATION OF MARKET	DOLLAR VALUE OF MARKET	MARKET BUYING HABITS	MARKET SOURCES OF SUPPLY	MANUFACTURER'S PRICE POLICY	DISTRIBUTION METHOD	PHYSICAL DISTRIBUTION OF GOODS	FIRM'S RELATION TO THE MARKET	COMPETITION - NEW LINE	COMPETITION - OLD LINE	COST FACTORS - MARKETING	SALES ORGANIZATION	SALES PROMOTION
1. THE MARKET														
WHAT INDUSTRIES WILL USE THE NEW PRODUCT?	✓	✓	✓	✓	✓	✓	✓	✓	✓			✓	✓	
WHAT IS THE GEOGRAPHIC LOCATION OF POTENTIAL CUSTOMERS?	✓		✓	✓	✓			✓				✓	✓	
WHAT IS THE GROWTH PROJECTION OF INDUSTRIES COMPOSING THE MARKET?	✓	✓	✓											
WHAT IS THE CONSUMPTION OF COMPARATIVE PRODUCTS IN CUSTOMER INDUSTRIES?	✓	✓	✓		✓									
2. BUYING HABITS OF THE MARKET														
WHAT IS THE TITLE OR POSITION OF THE PERSON WHO PLACES THE ORDER FOR THIS TYPE OF MERCHANDISE?				✓	✓	✓			✓				✓	
WHAT IS THE AVERAGE NUMBER OF PEOPLE WHO MUST BE CONTACTED IN EACH CUSTOMER FIRM BEFORE AN ORDER CAN BE CLOSED?				✓								✓	✓	
WHAT IS THE AVERAGE TIME NEEDED TO CLOSE A SALE?				✓	✓	✓	✓		✓			✓	✓	✓
WHAT RELATIVE WEIGHT DO BUYERS GIVE TO PRICE, QUALITY, SERVICE, SAFETY OR OTHER QUALITIES OF THIS AND SIMILAR PRODUCTS?				✓	✓							✓		
FROM WHAT SOURCES DOES EACH OF THE POTENTIAL CUSTOMER INDUSTRIES PROCURE ITS NEED FOR THIS AND SIMILAR PRODUCTS?				✓	✓		✓			✓		✓	✓	✓
AT WHAT SEASON IS BUYING DONE?				✓			✓	✓				✓	✓	
WHAT ARE THE PRACTICES ON DISCOUNTS, ALLOWANCES, CREDITS, OTHER FINANCIAL FACTORS?				✓								✓	✓	
3. FIRM RELATION TO MARKET														
IS THE FIRM ALREADY ESTABLISHED IN MARKET USING NEW PRODUCT?		✓	✓		✓		✓	✓		✓	✓		✓	✓
IS THE REPUTATION OF THE MANUFACTURER-SIZE OF FIRM, CHARACTER OF MERCHANDISE, OR ANY OTHER FACTOR CAPABLE OF CONSTRUCTIVE EXPLOITATION IN THE NEW MARKET?		✓	✓	✓		✓	✓	✓				✓	✓	✓
4. COMPETITION														
WHO ARE YOUR COMPETITORS IN THE NEW MARKET?	✓	✓			✓	✓	✓	✓	✓	✓	✓		✓	✓
WHAT IS THEIR STANDING WITH THE POTENTIAL CONSUMERS OF THE NEW PRODUCT?					✓	✓	✓	✓	✓	✓	✓		✓	✓
WILL MARKETING THE NEW PRODUCT INVITE MORE OR KEENER COMPETITION ON THE REGULAR LINE?	✓	✓	✓			✓	✓	✓	✓	✓		✓	✓	✓
CAN ANY COMPETITOR BRING OUT A SERIOUSLY COMPETITIVE NUMBER QUICKLY?						✓	✓	✓	✓			✓	✓	✓
5. SELLER'S PRICE POLICY														
WHAT, IN GENERAL, WILL BE THE PRICE POLICY ON THE NEW PRODUCT?				✓	✓		✓		✓	✓		✓	✓	
WHAT WILL BE THE SCHEDULE OF DISCOUNTS AND ALLOWANCES?				✓	✓		✓		✓	✓		✓	✓	
WHO WILL BE ENTITLED TO DISCOUNTS AND/OR ALLOWANCES?				✓	✓		✓		✓			✓		
WHAT NEW CREDIT FACILITIES WILL BE NEEDED?		✓	✓	✓	✓	✓	✓					✓		
WHAT DIFFERENCES WILL THERE BE IN COLLECTION POLICY?				✓	✓				✓			✓		
6. CHANNELS OF DISTRIBUTION														
IS THE MARKET SUBJECT TO WIDE FLUCTUATION - SEASONAL OR OTHERWISE?		✓		✓	✓	✓	✓	✓	✓			✓	✓	✓
WHAT TYPE OF DISTRIBUTION WILL BE USED -														
MANUFACTURER'S SALES BRANCES?	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
MANUFACTURER'S AGENTS OR DISTRIBUTORS?	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
HOME OFFICE SALES FORCE DIRECT TO CONSUMERS?	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
HOME OFFICE SALES FORCE TO WHOLESALERS, JOBBERS, ETC.?	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
WILL THE PRODUCT GO INTO THE EXPORT FIELD?	✓	✓	✓	✓		✓	✓					✓	✓	✓
WHERE WILL STOCKS BE MAINTAINED?		✓		✓	✓		✓	✓	✓	✓	✓	✓	✓	
7. SALES PROMOTION														
WILL THE NEW PRODUCT HAVE ITS OWN SALES PROMOTION SET-UP?	✓		✓	✓			✓		✓	✓	✓	✓	✓	✓
WILL A NEW ADVERTISING SECTION OR DEPARTMENT BE NEEDED?				✓			✓		✓	✓	✓	✓	✓	
WHAT TYPE OF ADVERTISING WILL FORM THE BASIS OF THE OPENING PROMOTIONAL EFFORT?		✓	✓				✓		✓	✓	✓	✓	✓	
WILL A NEW OR EXTEDED AGENCY CONNECTION BE NECESSARY?		✓	✓				✓		✓	✓	✓	✓	✓	
WHAT, IN GENERAL, WILL BE THE BASIS OF THE APPEAL?				✓			✓		✓	✓	✓	✓		✓
WHAT WILL BE THE BASIS OF THE SALES PROMOTION BUDGET?	✓	✓	✓				✓			✓	✓	✓	✓	
WHAT PROMOTIONAL WORK IS BEING DONE BY COMPETITORS?		✓								✓	✓			✓
8. MANAGEMENT OF SALES FORCE														
DOES ANY VISIBLE FACTOR OF THE MARKETING PROBLEM INDICATE THAT A SPECIAL SALES STAFF OR A SPECIAL SALES DEPARTMENT ENTIRELY SEPARATE FROM THE SALES ORGANIZATION HANDLING THE REGULAR LINE WILL BE NECESSARY?	✓	✓	✓	✓			✓		✓	✓	✓	✓		
WILL SALESMEN "SELL" OR "NEGOTIATE"?				✓			✓		✓	✓	✓	✓		
WILL ADDITIONAL SALESMEN BE NEEDED?	✓	✓	✓				✓		✓	✓	✓	✓		
DO SALESMEN NEED TECHNICAL TRAINING?				✓			✓		✓	✓	✓	✓		
WHAT SPECIAL AIDS; I.E., ENGINEERING, RESEARCH, ADVERTISING, ETC., WILL BE GIVEN TO THE SALES STAFF?	✓	✓	✓				✓			✓	✓	✓	✓	
WHAT WILL BE THE BASIS OF SALESMEN'S COMPENSATION?	✓	✓	✓				✓			✓	✓	✓	✓	
9. OTHERS														
IS OWNERSHIP OF THE NEW PRODUCT ESTABLISHED?							✓					✓		
IS ITS TRADE-MARK PROTECTED?				✓		✓	✓		✓			✓		
ARE ALL CLAIMS TO ROYALTIES OR OTHER INDEMNITIES SETTLED?												✓		
DO ROYALTIES LIMIT THE MARKET FOR THE PRODUCT?												✓		
DO TRADE AGREEMENTS LIMIT THE MARKET OR SALES EFFORT?				✓		✓	✓	✓		✓	✓	✓		
WHAT ARE THE EFFECTS OF CODES ON SALES METHODS? COMPETITION?				✓		✓	✓	✓		✓	✓	✓		
HAVE ALL TRANSPORTATION PROBLEMS, INCLUDING RATES, YARD AND SWITCHING CHARGES, SPEED OF HANDLING AND COSTS BEEN GIVEN FULL CONSIDERATION?												✓		
HAVE LOCAL TAX PROBLEMS AND OTHER CIVIC PROBLEMS BEEN SOLVED?												✓		

APPENDIX H

SALES OF ALL INDUSTRIES AS SHOWN BY 134,392 PLANTS IN 1935

Primary channels of distribution	Net sales 1935 (000 omitted)	Per cent of total
Total, all sales by manufacturers	43,801,214	100.0
To own wholesale branches	7,499,535	17.1
To industrial and other large users	10,742,251	24.5
To wholesalers and jobbers	10,134,396	23.2
To own retail stores	629,139	1.5
To retailers, including chains	8,412,051	19.2
To household consumers	795,488	1.8
Transfers to other plants in own company	4,350,795	9.9
Sales not distributed through usual channels or not allocated	1,237,559	2.8

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, p. 11.

APPENDIX I

Comparative Summary of Wholesale Distribution
(1935 and 1933)

	1935	Per cent gain over 1933	1933
Establishments	$176,756	8	$163,583
Net sales	42,802,913,000	43	30,009,590,000
Expenses	4,163,480,000	16	3,580,368,000
Employees	1,277,717	8	1,187,688
Active proprietors	97,225	3	94,483
Pay roll	2,049,483,000	24	1,659,487,000
Full time	2,003,246,000	25	1,600,525,000
Part time	46,237,000	22	58,962,000
Stocks, end of year	3,106,609,000	7	2,901,901,000

Source: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Wholesale Distribution, Vol. I, p. 8.

APPENDIX J

AGENT MIDDLEMEN, 1935

Kind of agent	Number	Sales (000 omitted)	Cost ratio,[a] %
Auction company	609	$ 382,857	2.7
Brokers	3,922	2,889,546	1.4
Commission men	3,135	2,662,491	2.6
Export agents	496	276,506	5.3
Import agents	335	212,573	4.9
Manufacturers' agents	7,548	768,619	5.8
Selling agents	1,712	1,439,710	4.4
Other agents	390	275,774	2.5
Totals	18,147	$8,908,076	2.9

[a] Not including compensation for services of proprietors and firm members in case of unincorporated businesses.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Wholesale Distribution, Vol. VI, p. 17.

APPENDIX K

SUMMARY OF NUMBER OF WHOLESALE ESTABLISHMENTS, NET SALES AND POPULATION BY CITY-SIZE GROUPS

City-size group	Wholesale establishment		Net sales 1935		Population 1930	
	Number	Per cent of total	Amount	Per cent of total	Number	Per cent of total
United States total	176,756	100.0	$42,802,913,000	100.0	122,775,046	100.0
Cities of more than 500,000 (13)	53,897	30.5	21,960,894,000	51.3	20,828,542	17.0
Cities of 100,000 to 500,000 (80)	30,735	17.4	10,228,139,000	23.9	15,497,194	12.6
Cities of 50,000 to 100,000 (98)	9,125	5.2	2,112,678,000	4.9	6,491,448	5.3
Cities of 20,000 to 50,000 (277)	11,930	6.7	2,296,800,000	5.4	8,694,312	7.1
Less than 20,000 and rural areas	71,069	40.2	6,204,402,000	14.5	71,263,550	58.0

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Wholesale Distribution.

APPENDIX L

AGENTS AND BROKERS, 1935

Type	Number	Sales (000 omitted)	Expense ratio[a]
All agents and brokers	18,147	$8,908,076	2.9
Agents and brokers of m.c.g.[b]	6,331	3,545,133	2.4
All auction companies	609	382,857	2.7
Auction companies of m.c.g.	49	4,223	12.7
Furniture and home furnishings	33	1,893	16.1
General merchandise	16	2,330	9.9
All brokers	3,922	2,889,546	1.4
Brokers of m.c.g.	1,933	1,751,783	1.3
Groceries (specialties)	1,743	1,523,176	1.3
Dry goods	88	198,426	.6
Other brokers	102	30,181	3.0
All commission merchants	3,135	2,662,491	2.6
Commission merchants of m.c.g.	280	369,749	3.8
Dry goods	98	269,053	4.0
Groceries (specialties)	96	74,540	2.5
Other commission merchants	86	26,156	4.7
All export and import agents	831	489,079	5.1
Export and import agents of m.c.g.	278	122,663	4.6
Groceries (specialties)	48	44,259	1.5
General merchandise	25	32,006	4.0
Other export and import agents	205	46,398	7.7
All manufacturers' agents	7,548	768,619	5.8
Manufacturers' agents of m.c.g.	2,884	381,151	4.1
Groceries (specialties)	246	98,975	2.2
Clothing and furnishings	636	76,507	3.8
Dry goods (specialties)	463	70,245	2.5
Other manufacturers' agents	1,539	135,424	6.4
All selling agents	1,712	1,439,710	4.4
Selling agents of m.c.g.	517	639,790	3.3
Dry goods (specialties)	228	457,761	3.0
Clothing and furnishings	137	110,035	3.6
Other selling agents	152	71,994	5.3
All other agents (largely of m.c.g.)	390	275,774	2.5

[a] Not including compensation for proprietors of unincorporated enterprises.

[b] M.c.g. refers to manufactured consumers' goods.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Wholesale Distribution, Vol. I, pp. 66–73, 1937.

APPENDIX M

Sales by Kind of Business Groups

	Per cent		
	1935	1933	1929
Food stores	25.2	27.1	22.1
Eating and drinking places	7.2	5.7	4.3
General stores with food	3.3	6.2	7.5
Department stores	10.0	10.2	8.9
General merchandise, dry goods, variety stores	4.0	5.3	4.3
Apparel group	8.0	7.7	8.6
Automotive	13.9	11.6	16.0
Filling stations	5.9	6.1	3.6
Furniture	3.9	3.8	5.6
Lumber, building, hardware group	5.6	5.4	7.8
Drug	3.7	4.3	3.4
Liquor stores	1.0		
Others	8.3	6.6	7.9

Source: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, p. 11.

APPENDIX N

Relative Distribution of Sales among Independents, Chains, and Other Types in 1935, for 26 Businesses Together with 1933 and 1929 Comparisons

	Independents			Chains			Other types		
	1935	1933	1929	1935	1933	1929	1935	1933	1929
All stores	73.1	71.3	77.5	22.8	25.4	20.0	4.1	3.3	2.5
Grocery stores	60.8	54.3	53.6	38.2	45.0	45.7	1.0	0.7	0.7
Combination stores (groceries and meats)	60.5	56.1	67.6	39.1	43.7	32.2	0.4	0.2	0.2
Beer and liquor stores	48.0	[a]	[a]	1.8	[a]	[a]	50.2[b]	[a]	[a]
Motor vehicle dealers	95.6	94.6	[a]	4.4	53.0	[a]	.....	0.1	[a]
Accessories—Tire, batteries dealers	50.0	[a]	[a]	50.0	[a]	[a]	.....	[a]	[a]
Filling stations	77.8	64.3	66.0	21.5	35.5	33.8	0.7	0.2	0.2
Department stores	61.4	67.3	72.1	26.7	23.9	16.7	11.9[c]	8.8	11.2
Variety stores	9.2	8.8	9.8	90.8	91.2	90.1	.....	....	0.1
Men's clothing and furnishings	78.0	76.5	77.9	21.0	22.0	21.2	1.0	1.5	0.9
Family clothing stores	78.9	79.2	71.5	20.6	20.3	27.3	0.5	0.5	1.2
Women's ready to wear	72.3	74.5	74.3	25.2	23.2	22.7	2.5	2 2	3.0
Shoe stores	43.3	46.5	53.5	50.0	46.2	38 0	6.7[d]	7.3	8.5
Furniture stores	86.0	84.6	83.9	13.5	14.2	14.2	0.5	1.2	1.9
Household appliances (radios)	48.1	33.2	[a]	12.6	21.5	[a]	39 3[e]	45.3	[a]
Radio dealers	75.6	82.7	79.0	23.1	15.6	19.1	1.3	1.7	1.9
Lumber and building material dealers	75.6	[a]	[a]	23.8	[a]	[a]	0.6	[a]	[a]
Hardware and implement stores	95.4	95.6	[a]	4.3	4.1	[a]	0.3	0.3	[a]
Restaurants and eating places	84.0	84.8	86.1	14.5	14.9	13.6	1.5	0.3	0.3
Drinking places	99.2	[a]	[a]	0.1	[a]	[a]	0.7	[a]	[a]
Cigar stores and stands	61.1	65.1	73.5	35.8	33.9	25.1	3.1	1.0	1.4
Fuel and ice dealers	82.7	[a]	[a]	16.5	[a]	[a]	8	[a]	[a]
Drugstores with fountains	71.1	74.0	81.2	28.8	25.1	18.5	0.1	9	0.3
Drugstores without fountains	84.1	[a]	[a]	15.4	[a]	[a]	5	0.9	[a]
Hay, grain, and feed stores	71.6	[a]	[a]	16.0	[a]	[a]	12.4[f]	[a]	[a]
Farm and garden supply stores	75.0	[a]	[a]	4.7	[a]	[a]	20.3[f]	[a]	[a]
Jewelry stores	90.3	93.6	93.0	8.9	5.9	6.4	0.8	0.5	0.6
Others	78.8	79.6	[a]	14.3	15.0	[a]	6.9	5.4	[a]

[a] No comparisons available.
[b] Principally state liquor stores.
[c] Principally mail orders.
[d] Principally leased departments.
[e] Principally utility operated stores.
[f] Principally consumers' cooperatives.

Source: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. 1, Part. 1, p. 24.

APPENDIX O

RETAILERS CLASSIFIED AS TO TYPE OF OPERATION, 1935

Type of operation	Number of stores	Sales (000 omitted)	Per cent sales
United States total	1,653,961	$33,161,276	100.0
Independents	1,474,149	24,246,112	73.1
Single-store	1,419,855	21,634,246	65.2
Two-store	40,897	1,749,849	5.3
Three-store	13,054	771,246	2.3
Local branch systems	343	90,771	0.3
Chains	127,482	7,550,186	22.8
Local	17,964	1,021,613	3.1
Sectional and national	107,593	6,413,596	19.3
Manufacturer-controlled	1,925	114,977	0.4
All other types	52,330	1,364,978	4.1
Leased department, independent	3,517	48,041	0.1
Leased department, chain	3,664	108,070	0.3
Utility-operated stores	3,936	123,242	0.4
Mail-order houses	378	420,027	1.3
Direct selling (house to house)	6,349	125,316	0.4
State liquor stores	2,053	160,665	0.5
Military post canteens	487	5,524	
Commissaries or company stores	1,888	113,126	0.3
Other types	30,058	260,967	0.8

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. IV, p. 13, 1937.

APPENDIX P

KINDS OF BUSINESS BY SIZE AND TYPE GROUP

	Independents and other types		Chain and mail-order units	
	Per cent of stores	Per cent of sales	Per cent of stores	Per cent of sales
Stores with sales of:				
$300,000 or more	0.4	18.5	2.1	27.6
100,000–299,999	1.6	15.5	9.9	24.2
50,000– 99,999	3.1	12.9	19.8	21.8
30,000– 49,999	6.0	13.7	23.4	14.6
20,000– 29,999	7.2	10.4	16.6	6.6
10,000– 19,999	17.7	14.9	16.9	4.2
5,000– 9,999	19.5	8.3	6.3	0.8
Less than 5,000	44.5	5.8	5.0	0.2

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, pp. 1–32.

APPENDIX Q

CHAINS AND INDEPENDENTS, 1935

Type of retailer	Number of establishments	Sales (000 omitted)	Per cent sales
Independent totals	1,477,666	$24,294,153	73.2
Department stores	1,711	2,034,945	6.1
Leased departments	3,517	48,041	0.1
All other independents	1,472,438	22,211,167	67.0
Chain totals	139,810	8,460,611	25.5
Department stores	2,423	883,101	2.7
Leased departments	3,684	108,070	0.3
State liquor stores	2,053	160,665	0.5
All other chain stores	131,650	7,308,775	22.0
Unclassified	36,485	406,512	1.3
United States totals	1,653,961	$33,161,276	100.0

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Chains, pp. 6, 8.

APPENDIX R

RETAIL SALES AND POPULATION BY GEOGRAPHIC DIVISIONS, 1935

Division	Population[a]		Sales	
	Thousands	Per cent	Thousands	Per cent
New England	8,497	6.7	$ 2,721,911	8.2
Middle Atlantic	27,245	21.4	8,460,917	25.5
East North Central	25,592	20.1	7,170,586	21.3
West North Central	13,708	10.8	3,521,954	10.7
South Atlantic	16,878	13.2	3,296,008	10.0
East South Central	10,512	8.2	1,386,429	4.2
West South Central	12,705	10.0	2,309,174	7.0
Mountain	3,746	2.9	1,100,728	3.3
Pacific	8,638	6.7	3,193,569	9.7
Totals	127,521	100.0	33,161,276	99.9

[a] Estimated, July 1, 1935.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, pp. 2–29, 1937.

APPENDIX S

PERCENTAGE OF SPECIFIC PRODUCTS MARKETED BY COOPERATIVE ASSOCIATIONS, 1921–1935

Year	Cotton[a]	Tobacco	Rice	Citrus	Almonds	Walnuts	Butter	Cheese	Livestock
1921–1922	5.2	12.9	34.8	50.4	72.8	87.3			
1922–1923	7.4	48.5	30.8	57.2	67.6	84.5			
1923–1924	8.9	46.2	26.3	52.6	63.2	84.3			
1924–1925	8.0	34.6	26.0	56.7	68.2	85.5			
1925–1926	9.1	20.1	26.6	58.6	65.9	80.5			
1926–1927	6.8	14.6	29.3	59.1	71.3	79.9	34.3	32.5	
1927–1928	6.4	1.8	24.6	57.6	62.4	84.0	34.4	30.7	
1928–1929	8.1	1.9	28.7	58.6	67.9	84.0	35.0	30.4	17.0
1929–1930	9.9	1.9	29.8	58.9	55.5	89.3	33.9	25.6	18.1
1930–1931	16.8	3.1	32.7	60.2	67.8	81.4	35.4	25.3	18.0
1931–1932	13.4	3.7	32.2	60.3	69.8	85.0	36.0	26.3	18.9
1932–1933	8.6	5.1	25.8	57.2	26.4	85.9	35.9	25.8	19.9
1933–1934	13.8	2.4	28.8	61.7	24.7	86.3	36.1	22.2	20.8
1934–1935	17.5	5.6	28.0	66.2	26.9	88.6	35.7	21.8	21.8

[a] Handled just by large-scale cooperative associations.

SOURCE: Elsworth, R. H., "Statistics of Farmers' Cooperative Business Organizations," pp. 23, 34, 46, 62, 68, 73, 84, Farm Credit Administration, Washington, 1936.

APPENDIX T

Cooperative Marketing Associations, 1935

Commodity group	Associations listed 1935[a]		Membership 1935[b]		Estimated business 1934–1935 season	
	Number	Per cent	Number	Per cent	Dollars (000 omitted)	Per cent
Dairy products	2,300	26.2	750,000	30.1	440,000	32.8
Grain	3,125	35.5	580,000	23.3	315,000	23.5
Fruits and vegetables	1,082	12.3	158,000	6.3	200,000	14.9
Livestock	1,197	13.6	410,000	16.5	175,000	13.0
Cotton and products	305	3.5	255,000	10.2	100,000	7.4
Poultry and products	164	1.9	85,000	3.4	53,000	3.9
Wool and mohair	119	1.3	71,000	2.9	15,700	1.2
Nuts	53	0.6	14,800	0.6	11,300	0.8
Tobacco	16	0.2	50,000	2.0	7,500	0.6
Forage crops	29	0.3	6,900	0.3	1,830	0.1
Miscellaneous	404	4.6	109,300	4.4	23,670	1.8
Totals	8,794	100.0	2,490,000	100.0	1,343,000	100.0

[a] Including independent local associations, federations, large-scale centralized cooperatives, sales agencies, and independent service-rendering associations, but not including subsidiaries or associations only renting unsold property.

[b] Includes members, contract members, shareholders, shippers, consignors, and patrons.

Source: Fetrow, Ward W., "Cooperative Marketing of Agricultural Products," p. 4, Farm Credit Administration, Cooperative Division, Washington, 1936.

APPENDIX U

Credit Sales Ratio, by Years

	Per cent of total sales		
	1935	1933	1929
Total sales	100.0	100.0	100.0
Cash and C.O.D. sales	67.8	72.3	65.7
Credit sales	32.2	27.7	34.3
Open-account credit	21.3	[a]	21.3
Installment credit	10.9	[a]	13.0[b]

[a] No breakdown of credit sales available for 1933.

[b] Approximate proportion based on limited sample.

Source: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, p. 1–20.

APPENDIX V

CREDIT AND CASH RATIOS FOR SELECTED KINDS OF BUSINESSES

Kind of business	Per cent of open account sales	Per cent of install-ment sales	Per cent of cash and C.O.D. sales
All stores	21.3	10.9	67.8
Candy and confectionery stores	2.2	....	97.8
Dairy product stores	58.8	....	41.2
Grocery stores (without meat)	15.9	....	84.1
Combination stores (grocery and meats)	23.2	....	76.8
Meat markets	15.5	....	84.6
Department stores	26.8	97.	63.5
Variety stores	0.1	....	99.9
Men's clothing	23.7	1.5	74.8
Family clothing	23.4	17.0	59.6
Women's ready-to-wear	24.6	1.6	73.8
Shoe stores	7.2	....	92.8
Motor vehicle dealers	10.0	59.9	30.1
Filling stations	21.8	0.4	77.8
Furniture stores	23.6	48.7	27.7
Household appliances and radio stores	19.6	54.9	25.5
Lumber and building material dealers	68.4	2.3	29.3
Hardware stores	34.7	3.4	61.9
Hardware and farm implement dealers	34.8	16.1	49.1
Drugstores	7.8	0.1[a]	92.1
Fuel and ice dealers	52.0	1.3	46.7
Jewelry stores	22.3	24.3	53.4

[a] Represents primarily installment sales of radio sets and household appliances.

SOURCE: U.S. Department of Commerce, Bureau of the Census, Census of American Business, 1935, Retail Distribution, Vol. I, p. 1-21.

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